83-539

No.

IN THE

Supreme Court of the United States

October Term, 1983

ARTHUR ANDERSEN & CO.,
COOPERS & LYBRAND,
ALEXANDER GRANT & COMPANY,
SOCIETE COMMERCIALE DE REASSURANCE and
SCOR REINSURANCE COMPANY,
Petitioners,

v.

JAMES W. SCHACHT, the Acting Director
of Insurance of the State of Illinois and
Liquidator of Reserve Insurance Company,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether Congress, in enacting the Racketeer Influenced and Corrupt Organizations ("RICO") Title of the Organized Crime Control Act of 1970, 18 U.S.C. §§ 1961-1968, intended to create a private treble damage cause of action for every common law fraud involving two or more uses of the United States mails, thereby creating, as the court of appeals held, a "runaway treble damage bonanza" and "a dramatically expansive, and perhaps insufficiently discriminate, tool for combating organized crime."

2. Whether, if such cause of action exists, it may be asserted by a corporation which (a) initiated the alleged fraud through the acts of its officers and directors, (b) has no fraud claim of its own, and (c) seeks recovery on behalf of its creditors, shareholders and other third parties already suing for their own alleged injuries.

3. Whether an independent auditor or a reinsurer, respectively, conducts or participates in the conduct of the affairs of an "enterprise," in violation of 18 U.S.C. § 1962(c), by merely examining and issuing a report or opinion upon allegedly false financial statements of the enterprise in the one case, or entering into a reinsurance agreement with the enterprise in the other case.

PARTIES BELOW

The plaintiff is the Acting Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company. The defendants are two reinsurance companies, two wholly-owned subsidiaries of American Reserve Corporation, the former officers and directors of Reserve Insurance Company, and three outside accounting firms that served as auditors of Reserve and/or its parent. [1]

The petitioners are the independent accounting firms [defendants in counts III and IV of the complaint (App. 23f-29f)] and the two reinsurance companies [defendants in counts I and II of the complaint (App. 30f-35f)].*

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[1] Specifically, the defendants are (a) reinsurance companies: Societe Commerciale De Reassurance ("SCOR") and Scor Reinsurance Company; (b) two wholly-owned subsidiaries of American Reserve Corporation: Guaranty Reinsurance Company and Reserve Insurance Managers, Ltd.; (c) former officers and directors: Isidore Brown, Roger O. Brown, Jules Dashow, Walter Y. Elisha, Norman M. Gold, Burton I. Koffman, Wallace J. Stenhouse, Jr., Hugo Uyterhoeven, Anthony M. Tortoriello, Donald J. Clarkin, Jerrold N. Fine, John W. Muldoon, Stanton L. Subeck, Michael L. Meyer, and John J. Tickner; and (d) the independent accounting firms: Arthur Andersen & Co., Coopers & Lybrand, and Alexander Grant & Company.

* Pursuant to Supreme Court Rule 28.1 petitioners provide the following information:

Arthur Andersen & Co., Coopers & Lybrand and Alexander Grant & Company are partnerships.

Societe Commerciale de Reassurance ("SCOR") is primarily owned by Caisse Centrale de Reassurance. SCOR's partially-owned subsidiaries are: SCOR U.S. Corporation; Gibraltar General Insurance Company; Anglo-Canada General Insurance Company; Forescor; Immoscor; and S.I.C.A.V. Placements-Reassurance. SCOR also has minority ownership interests in Anglo Permanent Corporate Holding Limited and S.C.D.R. Investments Limited. Scor Reinsurance Company is a wholly-owned subsidiary of SCOR U.S. Corporation and has a single affiliate, Southwest International Reinsurance Company.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	1
PARTIES BELOW	2
TABLE OF AUTHORITIES	iii
OPINIONS BELOW	3
JURISDICTION	3
STATUTES INVOLVED	3
STATEMENT	4
A. The Allegations Of Fraud And Injury	5
B. The Fraud-Based RICO Claim	5
C. Proceedings And Decisions Below	7
REASONS FOR GRANTING THE WRIT	9
I. THE DECISION OF THE COURT OF APPEALS INVITING FEDERALIZATION OF COMMON LAW FRAUD UNDER THE RICO TREBLE DAMAGE PROVISION DESERVES REVIEW BY THIS COURT	10
A. The Impact Of The Decision Below Justifies Review	11
B. The Reading Of The RICO Treble Damage Provision Given By The Court Of Appeals Is Contrary To The Intent Of Congress	13
1. The decision of the court of appeals conflicts with the statutory language	14
2. The decision of the court of appeals conflicts with the legislative history	17
3. The decision of the court of appeals conflicts with other court decisions	18
II. THIS COURT SHOULD DECIDE WHETHER A CORPORATION THAT PARTICIPATES IN A RICO VIOLATION MAY SUE FOR TREBLE DAMAGES TO BE DISTRIBUTED TO THIRD PARTIES ALREADY SUING IN THEIR OWN BEHALF	21

Page

III. THIS COURT SHOULD REVIEW THE DECISION BELOW THAT THE RICO CASE MAY PROCEED AGAINST THE INDEPENDENT OUTSIDE ACCOUNTANTS AND REINSURERS, RESPECTIVELY, AND RESOLVE THE CONFLICT BETWEEN THE DECISION BELOW AND A RECENT *EN BANC* DECISION OF THE EIGHTH CIRCUIT 23

CONCLUSION 26

STATUTORY APPENDIX A-1

APPENDICES (SEPARATELY BOUND)

APPENDIX A:

Opinion of Court of Appeals, dated April 8, 1983.... 1a

APPENDIX B:

Order of Court of Appeals Dated July 1, 1983, Denying Petitions For Rehearing And Suggestion For Rehearing *En Banc* and Amending Opinion 1b

APPENDIX C:

Decision on Pending Motions by the District Court, dated January 21, 1982 ..... 1c

APPENDIX D:

Order of Certification by the District Court, dated April 30, 1982 ..... 1d

APPENDIX E:

Judgment of the Court of Appeals, dated April 8, 1983 ..... 1e

APPENDIX F:

Complaint 1f

TABLE OF AUTHORITIES

	Page
CASES	
Adair v. Hunt International Resources Corp., 526 F. Supp. 736 (N.D. Ill. 1981)	14
Alfred Dunhill Ltd. v. Interstate Cigar Co., 499 F.2d 232 (2d Cir. 1974)	12
Arizona v. Pickrell, No. 16375-SA (Arizona Sup. Ct. July 21, 1983) (*en banc*)	15
Associated General Contractors of California, Inc. v. California State Council of Carpenters, 103 S.Ct. 897, 74 L. Ed. 2d 723 (1983)	10, 13, 14, 23, 25
Barr v. WUI/TAS, Inc., 66 F.R.D. 109 (S.D.N.Y. 1975)	19
Bays v. Hunter Savings Assoc., 539 F. Supp. 1020 (S.D. Ohio 1982)	13, 14, 19
Bell v. Health-Mor, Inc., 549 F.2d 342 (5th Cir. 1977)	12
Bennett v. Berg, 710 F.2d 1361 (8th Cir. 1983) (*en banc*)	24, 25
Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)	12
Brunswick Corp. v. Pueblo Bowl-O-Mat, 429 U.S. 477 (1977)	14, 17
Caldarone v. Brown, N.D. Ill. No. 80-C-6251	4
Carlson v. Coca-Cola Co., 483 F.2d 279 (9th Cir. 1973)	12
Cenco, Inc. v. Seidman & Seidman, 686 F.2d 449 (7th Cir.), *cert. denied*, 103 S.Ct. 177 (1982)	20, 21, 22
Cross v. Price Waterhouse & Co., [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,153 (D.D.C. 1983)	19
Dan River, Inc. v. Icahn, 701 F.2d 278 (4th Cir. 1983)	13, 20
Driebus v. Wilson, 529 F.2d 170 (9th Cir. 1975)	21
Epstein v. American Reserve Corporation, N.D. Ill. No. 79-C-4767	4
Erlbaum v. Erlbaum, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,772 (E.D. Pa. 1982)	14, 19
Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976)	10, 12

	Page
Globus v. Law Research Service, Inc., 418 F.2d 1276 (2d Cir. 1979)	22
Harper v. New Japan Securities Int'l, Inc., 545 F. Supp. 1002 (C.D. Cal. 1982)	12, 14, 18, 19
Heizer Corp. v. Ross, 601 F.2d 330 (7th Cir. 1979)	22
Hokama v. E. F. Hutton & Co., [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,415 (C.D. Cal. 1983)	19
Holland v. Alexander Grant & Co., Circuit Court of Cook County, Ill., No. 82-L-20764	4
Holland v. Arthur Andersen & Co., Circuit Court of Cook County, Ill., No. 82-L-20763	4, 22
Huddleston v. American Reserve Corp., Circuit Court of Cook County, Ill., No. 79-CH-3717	4
Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977)	23
Kleiner v. First National Bank of Atlanta, 526 F. Supp. 1019 (N.D. Ga. 1981)	14,20
Landmark Savings & Loan v. Loeb Rhoades, Hornblower & Co., 527 F. Supp. 206 (E.D. Mich. 1981)	19
LaSalle National Bank, et al. v. Stenhouse, Circuit Court of Cook County Ill., No. 82-L-17602	4
Meineke Discount Muffler Shops, Inc. v. Noto, 548 F. Supp. 352 (E.D.N.Y. 1982)	13
Morosani v. First National Bank, 703 F.2d 1220 (11th Cir. 1983)	20
Moss v. Morgan Stanley, No. 83-7120 (2d Cir. Sept. 9, 1983)	19, 20
Noland v. Gurley, 566 F. Supp. 210 (D. Colo. 1983)	19
North Barrington Development, Inc. v. Fanslow, 547 F. Supp. 207 (N.D. Ill. 1980)	19
Premier Electrical Construction Co. v. Miller-Davis Co., 422 F.2d 1132 (7th Cir.), *cert. denied*, 400 U.S. 828 (1970)	21
Reiter v. Sonotone Corp., 442 U.S. 330 (1979)	15
Russello v. United States, No. 82-472, *cert. granted*, 51 U.S.L.W. 3508 (Jan. 10, 1983)	9
Ryan v. Ohio Edison Co., 611 F.2d 1170 (6th Cir. 1979)	12

	Page
Salisbury v. Chapman, 527 F. Supp. 577 (N.D. Ill. 1981)	13
Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977)	13
State Farm Fire and Cas. Co. v. Estate of Caton, 540 F. Supp. 673 (N.D. Ind. 1982)	13
Touche Ross & Co. v. Redington, 442 U.S. 560 (1979)	10, 12
Trane Company v. O'Connor Securities, No. 83-7336 (2d Cir. September 19, 1983)	20
United States v. Ivic, 700 F.2d 51 (2d Cir. 1983)	10, 15
United States v. Mandel, 591 F.2d 1347 (4th Cir.), *opinion on rehearing*, 602 F.2d 653 (4th Cir. 1979) *(en banc)*, *cert. denied*, 445 U.S. 961 (1980)	16, 25
United States v. Turkette, 452 U.S. 576 (1981)	9, 10, 15
United States v. Zemek, 634 F.2d 1159 (9th Cir. 1980), *cert. denied*, 450 U.S. 916 (1981)	24
Van Schaick v. Church of Scientology of California, Inc., 535 F. Supp. 1125 (D. Mass. 1982)	13, 14, 20
Waterman Steamship Corp. v. Avondale Shipyards, Inc., 527 F. Supp. 256 (E.D. La. 1981)	19
STATUTES	
15 U.S.C. § 78bb	12
18 U.S.C. § 1961(1)	5, 6, 11, 14
18 U.S.C. § 1961(5)	5, 6
18 U.S.C. § 1962(a)	6, 15, 16
18 U.S.C. § 1962(b)	6
18 U.S.C. § 1962(c)	6, 7, 8, 12, 16, 23, 24, 25
18 U.S.C. § 1962(d)	6
18 U.S.C. § 1963	6, 9
18 U.S.C. § 1964(a)	6
18 U.S.C. § 1964(b)	6
18 U.S.C. § 1964(c)	3, 6, 7, 10, 15, 17, 18, 19
28 U.S.C. § 1254(1)	3
28 U.S.C. § 1292(b)	7

Page

LEGISLATIVE MATERIALS

115 Cong. Rec. 6993 (1969) 17,18
116 Cong. Rec. 35342 (1970) 18
H.R. Rep. No. 1549, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 4007 25
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MISCELLANEOUS

45 Antitrust & Trade Regulation Report (BNA) 235 (1983) 13
Pray, "Application of the Racketeer Influenced and Corrupt Organizations Act (RICO) to Securities Violations," 8 J. Corp. Law 411 (1983) 13
W. Prosser, *Law of Torts* § 130 (4th ed. 1971) 17
"RICO Attack on Pension Plan Counsel Attempted," *Legal Times,* August 15, 1983 13
United States Department of Justice RICO Guidelines, 5 Trade Regulation Reporter (CCH) ¶ 50,452 (1983) 10
Webster's Third New International Dictionary (1971) 25

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit (App. 1a-37a)[2] by Circuit Judge Wood, joined by Chief Circuit Judge Cummings and Senior District Judge Walter Hoffman, is reported at 711 F.2d 1343 (7th Cir. 1983). The reported opinion reflects an order of July 1, 1983 (App. 1b-2b) modifying the court of appeals' initial opinion, denying rehearing, and noting the dissenting votes of Circuit Judges Eschbach and Posner to rehear the case *en banc*.

The opinions of the district court (App. 1c-7c & 1d-2d) are not reported.

JURISDICTION

Petitioners seek review of the judgment of the court of appeals dated and entered April 8, 1983 (App. 1e), as modified by the above-described order entered on July 1, 1983. This petition is filed within ninety days of the order of July 1, 1983. This Court has jurisdiction to review the judgment by writ of certiorari pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The treble damage provision of the Racketeer Influenced and Corrupt Organizations ("RICO") Title of the Organized Crime Control Act of 1970, 18 U.S.C. § 1964(c), provides as follows:

> "Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee."

Other pertinent provisions of RICO are set forth in the Statutory Appendix. (pp. A-1 to A-6, *infra*)

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[2] Appendices except for the Statutory Appendix (pp. A-1 to A-6, *infra*) are separately bound.

STATEMENT

This case arises from the insolvency of an insurance company, Reserve Insurance Company ("Reserve"), a wholly-owned subsidiary of American Reserve Corporation ("ARC"). The basic allegations are that audited consolidated financial statements of ARC (a public company now in bankruptcy) and its subsidiaries from 1974 through 1977 underestimated the claims costs (or "loss reserves") of Reserve and failed to disclose reinsurance agreements and thereby concealed Reserve's insolvency; that these financial statements and documents relating to the reinsurance agreements were disseminated through the U.S. mails; and that these financial statements and documents relating to the reinsurance agreements defrauded Reserve, its policyholders, creditors and shareholders and the state insurance department, thereby enabling Reserve to continue in business and go deeper into insolvency until Reserve's liquidation began in 1979. Damages of $100 million to Reserve are alleged, trebled to $300 million. The complaint (App. 1f-70f) names as defendants the officers and directors of ARC and Reserve; two reinsurance companies; two wholly-owned subsidiaries of ARC; and three independent accounting firms that served as ARC's and/or Reserve's auditors during successive periods.

More than a half dozen lawsuits, in both state and federal court, have been brought arising from the collapse of ARC and its subsidiaries. The first federal suit was brought by shareholders of ARC, asserting claims under the federal securities laws. Various other suits (including this one) followed, each repeating the same basic allegations.[3] The complaint in this

[3] The remaining suits are: *Epstein v. American Reserve Corporation*, N.D. Ill. No. 79-C-4767 (ARC shareholders); *Holland v. Arthur Andersen & Co.*, and *Holland v. Alexander Grant & Co.*, Circuit Ct. of Cook County Ill., Nos. 82-L-20763 and 82-L-20764, respectively (ARC trustee in bankruptcy); *LaSalle National Bank v. Stenhouse*, Circuit Ct. of Cook County Ill., No. 82-L-17602 (creditor banks); *Caldarone v. Brown*, N.D. Ill. No. 80-C-6251 (permanent receiver of American Reserve Insurance Company "ARIC"); and *Huddleston v. American Reserve Corp.*, Circuit Ct. of Cook County Ill., No. 79-CH-3717 (Reserve policyholders). While the instant case was the first to advance a RICO claim, plaintiffs in the *Epstein*, *Caldarone*, and *Holland* lawsuits have now brought RICO claims as well.

case is unique, however, because it was the *first* to seek treble damages and the *first* to base federal jurisdiction exclusively upon RICO.

A. The Allegations Of Fraud And Injury.

The complaint purports to allege a common law fraud. The complaint alleges that, had Reserve's insolvency not been concealed, Reserve would have been shut down by the state insurance department. Concealment of the insolvency, therefore, allegedly allowed Reserve to remain in business for a time during which it was driven "deeper into insolvency." (App. 2a)

The complaint alleges that the perpetuation of Reserve in business caused injury not only to Reserve but also to policyholders, creditors and shareholders of Reserve. (App. 2a) Although plaintiff purports to represent those policyholders, creditors and shareholders (who would benefit from any recovery by plaintiff), the court of appeals held that the plaintiff, as successor to Reserve's claims, could assert only injury to Reserve itself—*i.e.*, the deepened insolvency. (App. 6a n.3) The court of appeals also recognized (amending its initial opinion) that since any recovery by Reserve would inure to the benefit of Reserve's policyholders, creditors, and shareholders, any recovery by the plaintiff in this case should result in a reduction of any damages otherwise recoverable by those separate claimants.[4] (App. 2b)

B. The Fraud-Based RICO Claim.

RICO, the sole purported basis for federal jurisdiction and treble damages in this case, is divided into definitional, proscriptive, and remedial or punitive parts. The *definitional* part provides that "racketeering activity" consists of offenses (frequently called "predicate acts") under state or other federal laws, including the federal mail and wire fraud statutes, 18 U.S.C. § 1961(1). The commission of any *two* of such predicate acts within a 10-year period is sufficient to constitute a "pattern of racketeering activity," 18 U.S.C. § 1961(5).

[4] The order of July 1 (App. 1b), among other things, deleted footnote 5 of the earlier opinion (App. 11a), which erroneously stated that the extent of duplicative litigation had not been called to the court's attention.

The *proscriptive* part of RICO, 18 U.S.C. § 1962, prohibits conduct that differs from commission of the predicate acts, specifically:

— the *investment* of "income derived" from a "pattern of racketeering activity" into an enterprise (18 U.S.C. § 1962(a));

— the *acquisition* of an enterprise "through a pattern of racketeering activity" (18 U.S.C. § 1962(b)); or

— the *conduct of the affairs* of an enterprise "through a pattern of racketeering activity" (18 U.S.C. § 1962(c)).[5]

Finally, RICO provides for *sanctions.* Criminal and civil sanctions may be sought by the government (18 U.S.C. §§ 1963, 1964(a) and 1964(b)). Under 18 U.S.C. § 1964(c), a private treble damage action is available to a person "injured in his business or property by reason of a violation" of the proscriptive part, 18 U.S.C. § 1962. This case was brought pursuant to § 1964(c).

With respect to the independent accounting firms, the complaint charges in Count IV (App. 32f-35f) that the annual mailings of allegedly false consolidated financial statements of ARC or Reserve which were examined and reported upon by the outside independent auditors (Arthur Andersen & Co. for the years 1974 and 1975; Coopers & Lybrand for 1976; and Alexander Grant & Company for 1976 and 1977) concealed the effect of the reinsurance agreements and the insolvency of Reserve, violated the mail fraud statute, and constituted "racketeering activity," 18 U.S.C. § 1961(1). Because more than two annual mailings are alleged, the complaint charges that the mailings constituted a "pattern of racketeering activity," 18 U.S.C. § 1961(5). (App. 34f ¶ 94) The complaint makes similar charges in Count II (App. 27f-29f) against the reinsurance companies and alleges that they transmitted documents relating to the reinsurance agreements through the mails.

[5] 18 U.S.C. § 1962(d) proscribes conspiracy to violate the provisions of subsections (a), (b) or (c).

The mailed financial statements and mailed documents relating to the reinsurance agreements allegedly defrauded Reserve, its policyholders, creditors and shareholders and the state insurance department, enabling Reserve to continue to operate its insurance business while insolvent and to increase further its indebtedness until liquidation began in 1979. The court of appeals, disregarding what it referred to as the "technical deficiencies" in the complaint, concluded that the complaint could be construed to allege "injury to Reserve as a result of [all] defendants' direct or indirect participation in the conduct of ARC's affairs through the alleged mail fraud in such a manner as to artificially prolong Reserve's existence and worsen its insolvency and losses." (App. 16a) The court of appeals concluded that, as so construed, the complaint "at least arguably" stated a violation of 18 U.S.C. § 1962(c). (App. 19a)

C. Proceedings And Decisions Below.

Defendants moved in the district court to dismiss the complaint on the ground, among others, that it did not state a claim for treble damages under RICO. The district court (Hon. Thomas R. McMillen) denied the motions to dismiss but certified its decision for interlocutory review pursuant to 28 U.S.C. § 1292(b) (App. 1d-2d) and the court of appeals accepted the appeal.[6]

After briefing and oral argument the court of appeals affirmed the denial of motions to dismiss. The court of appeals held that Reserve's deepening insolvency during the time it was perpetuated in business by the alleged predicate acts of mail fraud was an injury to Reserve's "business or property" caused by the "arguabl[e]" violation of 18 U.S.C. § 1962(c) and therefore was enough to enable Reserve to seek treble damages under 18 U.S.C. § 1964(c). However, Reserve's injury, if any, is alleged to have resulted solely from predicate acts—the mailing of the allegedly false financial statements and documents relating to the reinsurance agreements.

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[6] Prior to deciding whether to certify its decision, the district court urged the plaintiff to amend the complaint if he intended to do so, because the district court did not want to certify merely a question of interpretation of the complaint. Plaintiff elected to stand on the complaint. (App. 17a, n.8)

The opinion of the court of appeals thus invites a treble damage action for every alleged fraud involving two or more uses of the mails, despite the fact that Congress has never provided a private damage remedy for mail fraud. The court of appeals acknowledged that its conclusion would federalize "the common law of 'garden variety' business fraud." (App. 20a) Indeed, the court recognized that its opinion presaged a "dramatic" and "vast" expansion of federal jurisdiction that would swallow up common law fraud, eclipse litigation under the federal securities laws, and set in motion a "runaway treble damage bonanza for the already excessively litigious." (App. 20a, 36a) But the court of appeals considered itself powerless to avoid this result because the federal mail fraud statute had caused "a realignment of the federal-state role . . . in the criminal sphere" (App. 23a) and because the court was unable to discern any "legitimate principled criterion" by which private RICO suits could be limited to avoid this result. (App. 26a)

The court of appeals also held that Reserve (in whose shoes the plaintiff stands) was a proper plaintiff, even though all of its officers and directors allegedly took part in the underlying fraud charged in the complaint. The court acknowledged that principles of tort law would bar recovery on behalf of Reserve in a common law fraud case, but held that unspecified "federal policies" under RICO justified a different result. (App. 7a) Thus, the court of appeals' opinion permits treble damages in business fraud cases under RICO even where single damages are not recoverable at common law.

Finally, the court of appeals concluded that 18 U.S.C. § 1962(c) applies to anyone "associated with" an enterprise [ARC] and ignored the absence of any allegation in the complaint as to another essential element of a § 1962(c) violation—*conducting* the affairs of the enterprise [ARC]—which requires actual participation in the *operation* or *management* of the enterprise itself. The examination of and reporting upon the financial statements of an enterprise by an independent auditor does *not* constitute participation in the operation or management of the enterprise. Nor does entering into a reinsurance agreement constitute such participation.

A timely petition for rehearing and suggestion for rehearing *en banc* was denied with two Circuit Judges (Judges Eschbach and Posner) dissenting and voting to rehear the case *en banc*.

REASONS FOR GRANTING THE WRIT

This case presents issues of great importance to the proper guidance and administration of the federal courts and to the relationship between federal and state private remedies. Contrary to the express intention of Congress, and contrary to the decisions of other courts, the court of appeals ignored all principled limitations on the cause or type of injury necessary for recovery in private RICO treble damage actions. The unsupportable result of this interpretation of RICO by the court of appeals is the complete federalization of the law of fraud and the evisceration of principled limitations upon private remedies under other federal statutes, such as the securities laws.

The proper interpretation of RICO's provision for private treble damage suits is a matter of overwhelming importance. Absent review by this Court, the decision below will stimulate efforts to transform "garden variety" fraud claims into federal treble damage claims under RICO, which recently have increased dramatically. Moreover, as shown below and as indicated by the court of appeals' opinion itself, many lower court decisions have produced a state of disarray concerning the precise scope of the RICO private treble damage provision.

In these circumstances, the intervention of this Court at this time is critical. While this Court has previously addressed the criminal provisions of RICO, *see United States v. Turkette*, 452 U.S. 576 (1981), it has yet to address the provision for treble damage claims[7] — a private remedy which, lacking the control

[7] In *Turkette* this Court referred to civil provisions of RICO only to indicate that they have more limited scope than the criminal provisions, 452 U.S. at 585—an observation not heeded by the court below. This Court has granted a petition for certiorari in *Russello v. United States*, No. 82-472, *cert. granted*, 51 U.S.L.W. 3508 (Jan. 10, 1983), a case that concerns the government's use of the forfeiture provisions of 18 U.S.C. § 1963.

of prosecutorial discretion,[8] presents a special need for authoritative judicial guidance. This case presents the opportunity for this Court to define authoritatively the limitations on RICO treble damage actions, without impinging upon the public enforcement provisions of the statute. Although the case has not progressed beyond an early stage, this Court has reviewed cases in a similar procedural posture to decide important questions of law. *See, e.g., Associated General Contractors of California, Inc. v. California State Council of Carpenters,* 103 S. Ct. 897, 74 L. Ed. 2d 723 (1983); *Touche Ross & Co. v. Redington,* 442 U.S. 560 (1979); *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976). In this case, the court of appeals decided questions of law of major importance that are properly presented for review. Immediate review is justified, since postponement of review to await a case that has reached final judgment after trial would leave district courts to confront a growing multitude of private RICO cases without guidance for several years.

I. THE DECISION OF THE COURT OF APPEALS INVITING FEDERALIZATION OF COMMON LAW FRAUD UNDER THE RICO TREBLE DAMAGE PROVISION DESERVES REVIEW BY THIS COURT.

Under the private treble damage provision of RICO, 18 U.S.C. § 1964(c), treble damages are available to a person

> "injured in his *business or property by reason of a violation* of [18 U.S.C.] Section 1962. . . ." (emphasis added).

The opinion of the court of appeals invites any plaintiff whose injury is caused by an alleged common law fraud involving two or more uses of the mails to bring a RICO treble

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[8] Criminal prosecutions are governed by the RICO Guidelines of the United States Department of Justice, 5 Trade Reg. Rep. (CCH) ¶ 50, 452, which are described in *United States v. Ivic,* 700 F.2d 51, 64 (2d Cir. 1983). The Guidelines played an important role in the position of the government before this Court in *Turkette,* where the government assured this Court that "sound discretion" would be exercised in bringing RICO prosecutions, all of which had to be "reviewed and authorized by the Criminal Division of the Department of Justice in Washington, D.C." *United States v. Turkette,* Brief for the United States at 25 n.20.

damage action, alleging that an "enterprise" was conducted "through" a "pattern of racketeering activity," consisting of the mail fraud. The opinion rejects any limitation on the cause or type of injury cognizable under RICO and, in effect, invites a private treble damage suit for any injury flowing solely from predicate acts. The result, as acknowledged by the court of appeals, is a federalization of common law fraud causes of action. The impact of such a holding alone justifies this Court's review. Review is also needed because the court of appeals ignored congressional intent as reflected by the statutory language and legislative history.

A. The Impact Of The Decision Below Justifies Review.

If the decision below is allowed to stand, the private treble damage provision of RICO will have the greatest impact upon the case load of the federal judiciary since the original grant of diversity jurisdiction. Only by heeding the express intention of Congress and applying principled limitations upon the cause and type of injury redressable under RICO can the treble damage provision be kept from becoming a vehicle for complete federalization of common law fraud claims. This is imperative because of the inclusion among the predicate acts, 18 U.S.C. § 1961(1), of mail and wire fraud and the widespread use of the mails and wires in ordinary business transactions.

The court of appeals' rejection of any such principled limitation brings large areas of state law into the federal sphere and displaces important areas of federal law as well. Prominent among the federal statutes affected are the federal securities laws. Under the decision below, RICO treble damage claims will either displace express and implied remedies under the securities laws or will constitute still another charge to fling at and confuse a jury.[9] The carefully crafted express remedies

[9] Thus, as illustrated in related actions here (see n.3 *supra*), a shareholder allegedly deceived by financial statements or press releases could attempt to transform what would otherwise be a common law or securities fraud claim into a RICO claim. In such a case, two or more uses of the mails, or alleged securities law violations, would establish the requisite predicate acts

(footnote continues)

under the Securities Act of 1933 and the Securities Exchange Act of 1934, *see Ernst & Ernst v. Hochfelder, supra,* 425 U.S. at 195, 206-211, will be rendered superfluous. Limitations on those express remedies—such as the provisions that limit a claimant to "actual damages," *e.g.,* 15 U.S.C. § 78bb—will be eviscerated. Limitations on implied private actions—such as the purchaser-seller rule, *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975)—as well as this Court's refusal to imply private actions, *e.g., Touche Ross & Co. v. Redington, supra,* will be stripped of practical significance. The "danger of vexatious litigation" that presently accompanies securities claims, *Blue Chip Stamps, supra,* 421 U.S. at 740, will be exacerbated with a vengeance, as allegations of "racketeering" triple the *in terrorem* effect of securities class actions.

The consequences of the court of appeals' interpretation of the RICO treble damage provision are not confined to securities litigation, however. The decision below invites litigants to couch virtually any fraud allegation in the language of RICO. Such a reading of RICO completely circumvents prior congressional decisions not to provide a private damage remedy for mail fraud[10] or for "deceptive" practices violative of § 5 of the Federal Trade Commission Act.[11]

The lure of an unchecked private RICO remedy as a basis for federal jurisdiction can already be seen in an increasing

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(footnote continued)

for a "pattern of racketeering activity;" the corporate issuer would constitute the alleged "enterprise;" and a variety of potential defendants would be vulnerable to an allegation that they were persons "employed by or associated with" the "enterprise"—*i.e.,* the issuer—who "conducted or participated in the conduct of the affairs" of the enterprise "through a pattern of racketeering activity"—*i.e.,* the mail fraud or alleged securities law violations—thereby violating 18 U.S.C. § 1962(c). For an additional illustration of this phenomenon, *see, e.g., Harper v. New Japan Securities Int'l, Inc.,* 545 F. Supp. 1002, 1008 (C.D. Cal. 1982).

[10] *See Ryan v. Ohio Edison Co.,* 611 F.2d 1170, 1177-1179 (6th Cir. 1979); *Bell v. Health-Mor, Inc.,* 549 F.2d 342 (5th Cir. 1977) (no private action for mail fraud).

[11] *See, e.g., Alfred Dunhill Ltd. v. Interstate Cigar Co.,* 499 F.2d 232, 237-238 (2d Cir. 1974); *Carlson v. Coca-Cola Co.,* 483 F.2d 279, 280-281 (9th Cir. 1973) (no private action under § 5 of the FTC Act).

number of suits whereby litigants are attempting to use RICO to bring breach of contract, commercial bribery, and a variety of other business tort cases into the federal courts.[12] Indeed, some commentators have suggested that responsible lawyers are duty bound to use RICO to secure federal jurisdiction over what are otherwise doubtful claims.[13]

Whether Congress intended this result when it enacted the private treble damage provision of RICO as part of the Organized Crime Control Act of 1970 is obviously an issue worthy of this Court's attention. Unless review is obtained now, lower federal courts will become inundated with RICO treble damage suits whose ultimate jurisdictional status will remain uncertain.

B. The Reading Of The RICO Treble Damage Provision Given By The Court Of Appeals Is Contrary To The Intent Of Congress.

If Congress had intended the RICO treble damage provision to have the consequences just described—consequences envisioned by the court below when it labeled the provision a "runaway treble damage bonanza for the already excessively litigious"—one would expect to find a clear statement to that effect, either in the statute or in its legislative history. *Compare Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, 479 (1977)

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[12] *See, e.g., Dan River Inc. v. Icahn,* 701 F.2d 278 (4th Cir. 1983) (takeover litigation); *Meineke Discount Muffler Shops, Inc. v. Noto,* 548 F. Supp. 352 (E.D.N.Y. 1982) (allegations of common law fraud, breach of contract, and trademark infringement); *State Farm Fire and Cas. Co. v. Estate of Caton,* 540 F. Supp. 673 (N.D. Ind. 1982) (insurance fraud); *Bays v. Hunter Savings Assoc.,* 539 F. Supp. 1020 (S.D. Ohio 1982) (dispute concerning adequacy of disclosure of mortgage terms); *Van Schaick v. Church of Scientology of California, Inc.,* 535 F. Supp. 1125 (D. Mass. 1982) (action for fraud and infliction of emotional trauma); *Salisbury v. Chapman,* 527 F. Supp. 577 (N.D. Ill. 1981) (fraud in real estate transaction).

[13] *See* 45 Antitrust & Trade Reg. Rep. (BNA) at 235 (1983) (quoting commentator as recommending that "responsible clients and counsellors" consider asserting a RICO claim to bolster an antitrust claim that presents "a problem with standing" and suggesting that the suit rejected by this Court in *Associated General Contractors, Inc., supra,* could succeed as a RICO suit). *See also* Pray, "Application of the Racketeer Influenced and Corrupt Organizations Act (RICO) to Securities Violations," 8 J. Corp. Law 411 (1983); "RICO Attack On Pension Plan Counsel Attempted," *Legal Times,* August 15, 1983 at 7.

(Congress cannot be presumed "absent a clear indication" to "federalize" large areas of state law). In the case of RICO, there is *no* such statement. Indeed, both the language and legislative history of RICO indicate that the private treble damage provision—added late in the process of enacting this predominantly *criminal* statute[14]—was not intended to affect such far-ranging upheavals in the relationship between federal and state *private* remedies. Although language and legislative history are enough to refute any contention that Congress intended to federalize common law fraud under RICO, the same conclusion is supported by accepted principles of statutory interpretation that subordinate even very broad language to a clearly discerned statutory purpose. *See Associated General Contractors of California, Inc., supra; Brunswick Corp. v. Pueblo Bowl-O-Mat,* 429 U.S. 477 (1977).

1. The decision of the court of appeals conflicts with the statutory language.

The statutory language, which makes treble damages available to a person "injured in his business or property by reason of a violation of § 1962," negates an intent to create a treble damage remedy simply for injury caused by mail fraud (as to which no private action has ever existed, even for single damages) or any of the other predicate acts. If Congress had intended to enact a remedy for predicate acts like mail fraud, it could have done so by providing for damages to any person injured by reason of a pattern of racketeering activity as defined in § 1961. As recognized by a number of courts, Congress' choice of different language, requiring injury "by reason of *a violation of § 1962*" (emphasis added) shows that adding a remedy for predicate acts listed in § 1961 was not Congress' intent.[15]

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[14] *See* note 17, *infra.*

[15] *See Erlbaum v. Erlbaum,* [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,772 at 93,922 (E.D. Pa. 1982) ("[i]f Congress [had] intended that § 1964 compensate injuries caused by racketeering activity it could have made reference to § 1961(1) rather than § 1962.") *Accord, e.g., Bays v. Hunter Savings Assoc. supra,* 539 F. Supp. at 1023; *Harper v. New Japan Securities Int'l, supra,* 545 F. Supp. at 1005-1008; *Van Schaick v. Church of Scientology, supra,* 535 F. Supp. at 1135-1137; *Adair v. Hunt International Resources Corp.,* 526 F. Supp. 736, 746-748 (N.D. Ill. 1981); *Kleiner v. First National Bank of Atlanta,* 526 F. Supp. 1019, 1022 (N.D. Ga. 1981).

The express requirement of "business or property" injury under 18 U.S.C. § 1964(c) confirms this conclusion. A reference to "business or property" injury excludes personal injury, *see Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979), and Congress would not have enacted this exclusionary language if its intention had been to create a treble damage remedy for victims of predicate racketeering offenses that inflict personal injury, such as murder or kidnapping.[16]

The type of injury Congress *did* intend to remedy under the RICO treble damage provision is a distinct form of business injury caused by the unlawfully-gained economic advantage which a racketeer obtains over legitimate business. This conclusion is clear when the statutory language is read in light of RICO's primary purpose, which, as this Court held in *Turkette, supra,* was to "cope with the infiltration of legitimate businesses" by organized crime. 452 U.S. at 591. As observed recently by Judge Friendly,

> "From the start Congressional concern centered on the problem of 'black money,' the purchase and operation of legitimate businesses with the proceeds of illegal endeavors." *United States v. Ivic, supra,* 700 F.2d at 62 (citing legislative history).

The primary, anti-infiltration purpose of RICO is most directly addressed by 18 U.S.C. § 1962(a) of RICO, which makes it a violation for a person to invest "income derived" from a "pattern of racketeering activity" into a distinct "enterprise." As stated in *Turkette,* the purpose of RICO civil remedies is to deal with the "ill-gotten gains" that may be so invested. 452 U.S. at 585. Where "ill-gotten gains" are invested in an enterprise in violation of § 1962(a), the person

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[16] In this regard it is instructive to contrast § 1964(c) with the Arizona RICO-type statute, which allows treble damages to a person "who sustains injury to his *person,* business or property *by racketeering . . . or* by a violation" of the Arizona RICO statute. Ariz. Rev. Stat. Ann. § 13-2314 (emphasis added) The Arizona Supreme Court has observed that the wording of the federal statute is more restrictive than that of the Arizona statute, and that under the federal statute there is "no cause of action for one injured directly by racketeering." *Arizona v. Pickrell,* No. 16375-SA (Arizona Sup. Ct. July 21, 1983) (*en banc*).

"injured in his business or property by reason of" the violation is a person whose injury flows from the *investment* in the enterprise. A person whose injury stems from the underlying pattern of racketeering activity from which the income was derived—such as a person whose money was taken in a swindle—has not been injured "by reason of" the RICO violation, since it is not the obtaining of such ill-gotten gains but instead the investment of them into an "enterprise" that constitutes the RICO violation. The proper RICO plaintiff, therefore, is the person injured economically by the investment of the ill-gotten gains in the enterprise—not the person injured, however grievously, by the taking of those gains in the first place.

In this case, it is alleged that mail fraud was committed when allegedly false audited financial statements of ARC and Reserve and documents relating to the reinsurance agreements were sent through the mails. The court of appeals construed the complaint to allege further that ARC was an "enterprise" conducted "through" the mail fraud, in violation of 18 U.S.C. § 1962(c). The claimed injury, while arguably the basis for a state law claim, is *not* the kind of injury for which Congress enacted the RICO treble damage provision.

Like § 1962(a) which it complements, the prohibition of § 1962(c) of RICO is aimed at the same evil—the securing of economic advantage for an "enterprise" controlled or financed by racketeers. Whereas § 1962(a) proscribes the investment of "income derived" from racketeering into an enterprise, § 1962(c) proscribes the use of racketeering activity to conduct the affairs of the enterprise—creating economic advantage for the enterprise that is equivalent to investment in the enterprise of funds from an outside source. *See United States v. Mandel*, 591 F.2d 1347, 1375 (4th Cir.), *opinion on rehearing*, 602 F.2d 653 (4th Cir. 1979) *(en banc)*, *cert. denied*, 445 U.S. 961 (1980). As when a violation of § 1962(a) is the basis for a treble damage claim, a treble damage suit based upon a violation of § 1962(c) requires injury distinctively caused by the RICO violation, and not merely caused by the predicate acts. When a violation of § 1962(c) is alleged, a RICO plaintiff must allege injury caused by the economic advantage the

enterprise obtained by the violation, not merely injury that has occurred because of the predicate acts themselves.

The complaint in the present case is deficient in this regard. The injury to "business or property by reason of" any RICO violation alleged may have been incurred by other insurance companies from which Reserve may have diverted business—a form of injury for which there may be no other remedy. The complaint, however, does not allege that plaintiff or anyone he claims to represent suffered injury of this type.

2. The decision of the court of appeals conflicts with the legislative history.

The legislative history of RICO is devoid of any suggestion that injury resulting from predicate acts may be redressed by a treble damage suit under RICO. The court of appeals erred in concluding otherwise. As Senator Hruska, orginator of the language that now appears in 18 U.S.C. § 1964(c) explained, the treble damage provision of RICO was modeled on § 4 of the Clayton Act and was intended for use by "the honest businessman who has been damaged by unfair competition from the racketeer businessman." Senator Hruska expressed concern that, while such a legitimate businessman theoretically might have a remedy under the antitrust laws, the antitrust remedy might be unavailable "as a practical matter." The Senator's proposal to aid "the businessman competing with organized crime" was designed to redress this particular form of economic disadvantage. 115 Cong. Rec. 6993 (1969).

Perhaps concerned that courts might otherwise superimpose such antitrust doctrines as a requirement of injury to competition and not just injury to the business or property of a plaintiff, *see Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., supra,* 429 U.S. at 489, Senator Hruska apparently did not intend to require antitrust injury. Instead, he invoked the concept of *unfair* competition, which has historically protected not competition at large but an individual entrepreneur's business opportunity. *See generally* W. Prosser, *Law of Torts* § 130 at 950-956 (4th ed. 1971).

Thus, the statements by the originator of the language of 18 U.S.C. § 1964(c) clearly show that the intent was *not* to create a new remedy for predicate acts such as mail fraud, but instead to direct the new remedy at a specific form of business injury—the impairment of a businessman's ability to compete because of unlawfully obtained economic advantage—a form of injury perceived to lack any *other* effective remedy at the time. Although Senator Hruska's proposed treble damage remedy was deleted from the organized crime bill passed by the Senate, Senator Hruska's language was restored in the House, where the Senator's intention as to the purpose of the language was reaffirmed. For example, then-Representative Mikva, an opponent of RICO who might have tended to overstate its "horribles," specifically addressed the treble damage provision and criticized it only on the ground that it could be abused when "any *competitor* may go in and seek three-fold damages." 116 Cong. Rec. 35342 (1970) (emphasis added).[17]

3. The decision of the court of appeals conflicts with other court decisions.

Although there are decisions going both ways on the issue (App. 27a-28a), numerous district courts have recognized that

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[17] Senator Hruska's treble damage proposal was originally made in the 90th Congress as part of a package of proposed anti-racketeering amendments to the antitrust laws. When those proposals lapsed in the 90th Congress, the Senator reintroduced them in the 91st Congress as separate legislation. 115 Cong. Rec. 6993 (1969). Section 4(a) of Senator Hruska's bill in the 91st Congress (S.1623) contains the provisions enacted as 18 U.S.C. § 1964(c). Although S.1623 was referred to the Senate Judiciary Committee, the bill reported by that Committee and passed by the Senate (S.30, the forerunner of the Organized Crime Control Act of 1970) had *no provision for private remedies* in the RICO title. *See* S. Rep. No. 617, 91st Cong., 1st Sess. (1969). After the House added Senator Hruska's proposed treble damage language as part of a package of amendments to the Senate-passed organized crime bill, the Senate then acquiesced in all House amendments. For a review of the pertinent legislative history, *see Harper v. New Japan Securities Int'l, Inc., supra,* 545 F. Supp. at 1004-1005.

The statements of Senator Hruska quoted in text were completely ignored by the court below. Instead, the court of appeals cited other statements in congressional debates (App. 28a-30a), but did not acknowledge that such statements referred to the criminal provisions of RICO and in many cases concerned proposed legislation that contained no private remedy at all.

a RICO plaintiff must show injury distinctively caused by the RICO violation and have held that injury flowing from an alleged mail fraud does not suffice. *See, e.g., Moss v. Morgan Stanley,* No. 83-7120, slip op. at n.16 (2d Cir. Sept. 9, 1983) (corrected opinion) (noting a "growing number of courts that have limited standing under 18 U.S.C. § 1964(c) to those 'plaintiffs alleging something more, or different, than direct injury resulting from the predicate acts,' " citing cases; court declines to resolve issue for Second Circuit); *Noland v. Gurley,* 566 F. Supp. 210, 218 (D. Colo. 1983); *Cross v. Price Waterhouse & Co.,* [1982-83 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,153 at 95,567-68 n.4 (D.D.C. 1983); *Erlbaum v. Erlbaum, supra,* [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 93,922-23; *Harper v. New Japan Securities Int'l., Inc., supra,* 545 F. Supp. at 1005-1008; *Bays v. Hunter Savings Assoc., supra,* 539 F. Supp. at 1023; *Landmark Savings & Loan v. Loeb Rhoades, Hornblower & Co.,* 527 F. Supp. 206, 208-209 (E.D. Mich. 1981); *North Barrington Development, Inc. v. Fanslow,* 547 F. Supp. 207, 210-11 (N.D. Ill. 1980).

Some of the foregoing decisions have labeled the injury redressable under 18 U.S.C. § 1964(c) as "racketeering enterprise injury" or "competitive injury." Of less importance than the label, however, is the conclusion that injury traceable to predicate acts—such as mail fraud—is *not* enough to support a RICO treble damage claim.

In addition to the foregoing decisions recognizing this compelling injury requirement, a number of decisions have suggested or imposed other limitations upon private RICO actions. For example, several decisions have required allegations of organized crime involvement in private RICO cases. *See, e.g. Hokama v. E. F. Hutton & Co.,* [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,415 at 96,384-85 (C.D. Cal. 1983); *Waterman Steamship Corp. v. Avondale Shipyards, Inc.,* 527 F. Supp. 256, 260 (E.D. La. 1981); *Barr v. WUI/TAS, Inc.,* 66 F.R.D. 109, 113 (S.D.N.Y. 1975). *But see, e.g., Moss v. Morgan Stanley, Inc., supra* (corrected opinion). Other courts have indicated doubts about whether a private RICO action can be maintained in the absence of a conviction or indictment for the

predicate acts or the RICO violation. *Van Schaick v. Church of Scientology, supra,* 535 F. Supp. at 1137 n.12; *Kleiner v. First National Bank of Atlanta, supra,* 526 F. Supp. at 1022 n.2. *See also Trane Company v. O'Connor Securities,* No. 83-7336 (2d Cir. September 19, 1983) (reserving decision on whether conviction of predicate acts is required in private RICO case).

The current state of the law concerning private RICO shows disarray and a need for this Court's intervention to provide uniform guidance on the elements of a RICO treble damage claim. The court of appeals is not alone in upholding private RICO claims proceeding on a common law fraud theory, but the Seventh Circuit panel is the first appellate court to legitimize a "runaway treble damage bonanza" under RICO. (App. 36a) Other courts of appeals have tried either to avoid passing upon the injury issues decided by the court of appeals here or to apply other limiting principles to prevent private RICO actions from swallowing common law fraud. *See, e.g., Dan River, Inc. v. Icahn, supra,* 701 F.2d at 291 (private RICO action appeared "far removed from the context which Congress had in mind when it enacted the statute"); *Moss v. Morgan Stanley, Inc., supra,* slip op. at n.16 (corrected opinion) (Second Circuit declined to resolve injury requirements while deciding that plaintiff who was not the victim of fraud had no fraud-based RICO claim); *Morosani v. First National Bank,* 703 F.2d 1220, 1222 (11th Cir. 1983) (Eleventh Circuit addressed nature of mail fraud under RICO but specifically declined to consider other limiting principles). *See also Cenco, Inc. v. Seidman & Seidman,* 686 F.2d 449, 457 (7th Cir.), *cert. denied,* 103 S.Ct. 177 (1982) (Congress did not intend to create "waves of treble damage suits" in the "wake of every RICO violation;" accounting firm not permitted to sue audited company on a fraud-based RICO claim).

This Court's intervention is now imperative. Without this Court's review at this time, the erroneous interpretation of the RICO treble damage provision given by the court of appeals may be perpetuated, and the burdens on courts and litigants set in motion by the "runaway treble damage bonanza" will be impossible to undo.

II. THIS COURT SHOULD DECIDE WHETHER A CORPORATION THAT PARTICIPATES IN A RICO VIOLATION MAY SUE FOR TREBLE DAMAGES TO BE DISTRIBUTED TO THIRD PARTIES ALREADY SUING IN THEIR OWN BEHALF.

An anomaly of the decision below is that it upholds a fraud-based RICO treble damage claim brought on behalf of Reserve, whereas Reserve has no fraud claim for single damages. The complaint alleges that every officer and director, of Reserve, as well as of ARC (Reserve's sole shareholder) was aware of Reserve's insolvency, and that the allegedly false financial statements of Reserve and the reinsurance agreements concealed the insolvency from persons outside Reserve and allowed Reserve to remain in business. As the court of appeals recognized, under Illinois law governing the attribution of knowledge or actions to corporations—which the Seventh Circuit had just applied in the non-RICO aspects of *Cenco, Inc. v. Seidman & Seidman, supra*—Reserve had no claim against outsiders that it had been defrauded as to its own financial condition.[18] With plaintiff thus unable to bring a *fraud* claim on behalf of Reserve, the court of appeals held that the plaintiff could nevertheless bring a fraud-based *RICO* claim because of unspecified "federal policies." (App. 7a)

The attribution principles governing claims by corporations that the court of appeals discarded in the context of RICO are, however, applicable to claims under a variety of federal statutes, including the antitrust and securities laws. For example, a full, willing, and equal participant in an alleged antitrust violation cannot maintain a treble damage suit. *E.g., Driebus v. Wilson,* 529 F.2d 170 (9th Cir. 1975); *Premier Electrical Construction Co. v. Miller-Davis Co.,* 422 F.2d 1132, 1138 (7th Cir.), *cert. denied,* 400 U.S. 828 (1970). Similarly, in actions under the federal securities laws, an entity committing "serious wrongdoing" cannot escape "scot-free" by

[18] Plaintiff tried to overcome this difficulty by alleging that, as successor to Reserve's claims, he represented Reserve's policyholders, creditors, and shareholders. However, the court of appeals recognized that under Illinois law the director could pursue "no action which could not have been asserted directly by Reserve before liquidation." (App. 6a n.3)

shifting its entire loss to an outsider. *Cenco, Inc. v. Seidman & Seidman, supra,* 686 F.2d at 458; *Heizer Corp. v. Ross,* 601 F.2d 330, 334-335 (7th Cir. 1979); *Globus v. Law Research Service, Inc.,* 418 F.2d 1276, 1287-1288 (2d Cir. 1969), *cert. denied,* 397 U.S. 913 (1970).

The allegations of the complaint in this case charge that Reserve was a willing, equal participant in any RICO violation and Reserve therefore should not be permitted to bring a RICO treble damage action against an outsider. The court of appeals held, however, that the alleged acts and knowledge of Reserve's officers, directors, and shareholders should not be attributed to Reserve because, with Reserve in liquidation, any recovery by Reserve would go first to Reserve's policyholders and creditors, who were "entirely innocent parties," and Reserve's shareholders (in reality, its sole shareholder, ARC) would be "last in line for recovery." (App. 10a) This reasoning of the court of appeals will not withstand analysis and provides no justification for discarding attribution principles of otherwise universal application.

The "entirely innocent parties" cited by the court of appeals—Reserve's policyholders and creditors—have brought their *own* suits for damages; indeed there is also a suit by Reserve's sole shareholder [ARC] which plaintiff also purports to represent and which the court of appeals did *not* characterize as "entirely innocent." By allowing a suit to be maintained on behalf of Reserve itself, the court of appeals introduced the considerable risk of duplicative recovery (because multiple suits have been brought for the same or overlapping injury[19]), and the risk of participation by alleged wrongdoers in any recovery of treble damages.

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[19] *See* n.3, *supra.* The history of the litigation brought by the bankruptcy trustee of ARC vividly demonstrates the mischief of the interpretation given RICO by the court below. On July 22, 1983, the trustee's state court complaint in *Holland v. Arthur Andersen & Co.,* (Cir. Ct. Cook Cty, Ill., No. 82-L-20763) was dismissed on the ground, among others, that state law gave ARC no fraud claim against outside accounting firms for the alleged "concealment" of facts known to ARC's directors and officers. The ARC trustee responded to the dismissal of his fraud complaint in state court by filing a fraud-based *RICO* complaint in *federal* court. *Holland v. Arthur Andersen & Co.,* N.D. Ill. No. 80-B-4786, Adversary Proceeding 83-A-2485.

There is a strong federal policy favoring avoidance of "either the risk of duplicate recoveries on the one hand, or the danger of complex apportionment of damages on the other." *Associated General Contractors, Inc., supra,* 103 S. Ct. at 912, 74 L. Ed. 2d at 742. *See also Illinois Brick Co. v. Illinois,* 431 U.S. 720, 730-736 (1977). This policy has special force where the injury results, not from a wrong done to the plaintiff, but from a "chain" of actions allegedly taken against third parties. *Associated General Contractors, Inc., supra,* 103 S. Ct. at 910, 74 L Ed 2d at 739. This situation is presented here. The injury alleged is "deepening of Reserve's insolvency" (App. 13a)—not by a fraud upon Reserve (or upon its sole shareholder, ARC), but by an alleged fraud upon the state insurance department, which then allegedly permitted ARC's and Reserve's directors to continue operating Reserve "beyond its insolvency." (App. 31a)

In enacting RICO, Congress gave no indication that it intended the courts to ignore these principles and policies against multiple suits for the same or overlapping injury, and the court of appeals offered no justification for discarding them. The decision below will unnecessarily proliferate the number of RICO suits; defendants will either be subjected to the risk of duplicative treble damage recoveries or the courts will have to undertake enormously complicated—and perhaps futile—efforts to apportion damages. This Court should review the court of appeals' decision allowing this result.

III. THIS COURT SHOULD REVIEW THE DECISION BELOW THAT THE RICO CASE MAY PROCEED AGAINST THE INDEPENDENT OUTSIDE ACCOUNTANTS AND REINSURERS, RESPECTIVELY, AND RESOLVE THE CONFLICT BETWEEN THE DECISION BELOW AND A RECENT *EN BANC* DECISION OF THE EIGHTH CIRCUIT.

Section 1962(c) of RICO makes it unlawful for a "person" that is "employed by or associated with" an "enterprise" to "conduct or participate in the conduct of the affairs" of that enterprise "through a pattern of racketeering." Reading the complaint to allege a violation of § 1962(c) involving ARC as

the enterprise, the court of appeals held that each of the following was properly included as a defendant:

> a) the three independent accounting firms that are alleged [in count IV (App. 32f-35f)] to have examined and reported on the financial statements of ARC and/or Reserve; and
>
> b) the two reinsurers that are alleged [in count II (App. 27f-29f)] to have been involved in the mailing of these statements and to have mailed documents relating to the reinsurance agreements.

The sole basis for the conclusion that a violation of § 1962(c) was alleged against the foregoing defendants was the statement that 18 U.S.C. § 1962(c) applies to anyone "associated with" an enterprise. (App. 34a) Section 1962(c), however, does not prohibit association with an enterprise. There is an additional, critical element under § 1962(c)—a defendant must "conduct" or "participate . . . in the conduct of" the "affairs" of the enterprise. The court of appeals ignored this element.[20]

The court of appeals' opinion conflicts in this regard with the recent *en banc* decision of the Eighth Circuit in *Bennett v. Berg*, 710 F.2d 1361 (8th Cir. 1983). Although the *en banc* Eighth Circuit reversed the dismissal of a RICO complaint, the court directed the district court to require the plaintiff to show the basis for charging a number of professionals and entities outside the "enterprise" with violations of § 1962(c). In line with decisions in two other circuits, the Eighth Circuit held that under § 1962(c), a "defendant's participation must be in the conduct of the affairs of a RICO enterprise, which ordinarily will require some participation in the operation or management of the enterprise itself." *Id.* at 1364. *See United States v.*

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[20] Although ignored by the court below, this issue was briefed by the parties, once the plaintiff, in his brief on appeal, set forth the § 1962(c) violation that the court below held the complaint could be read to allege. *See, e.g.*, Brief of Arthur Andersen & Co., September 7, 1982 at 26, n.5; Reply Brief of Accountant Appellants Alexander Grant & Co. and Coopers & Lybrand, November 5, 1982 at 28-30; Reply Brief of SCOR, November 5, 1982 at 14-17.

Zemek, 634 F.2d 1159, 1172 (9th Cir. 1980), *cert. denied*, 450 U.S. 916 (1981); *United States v. Mandel, supra*, 591 F.2d at 1375-1376.

Accordingly, the Eighth Circuit in *Bennett v. Berg* remanded the case so that various outside defendants could raise by "appropriate motions" whether they should "remain in the case until its conclusion on the merits." 710 F.2d at 1365. The court observed that a "district court must retain the power to insist upon some specificity in pleading before allowing a potentially massive factual controversy to proceed." *Id.* at 1365, citing this Court's decision in *Associated General Contractors of California, Inc., supra.*

The requirement that a defendant charged with violating § 1962(c) be involved in the operation or management of the enterprise is supported by the definition of "conduct"[21] as well as by the legislative history. *See* H. R. Rep. No. 1549, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. Code Cong. & Ad. News 4007, 4010. The complaint in this case, however, attacks the accounting firms only as outside auditors, who report upon financial statements but d not participate in management of the audited company. It attacks the reinsurers only as companies that contracted with Reserve and its affiliates. This Court should grant review to correct and clarify the proper application of the essential elements of § 1962(c).

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[21] RICO § 1962(c) uses "conduct" as both a verb and a noun. As a verb, "conduct" is defined as "to have the direction of: run, manage, direct" and is synonymous with "manage, control or direct." *Webster's Third New International Dictionary* 474 (1971). When used as a noun, it refers to the "act, manner or process or carrying out (as a task) or carrying forward (as a business, government, or war)." *Id.* at 473. The construction of § 1962(c) set forth in the text is derived from the plain dictionary meaning of the statutory language.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: September 29, 1983

STATUTORY APPENDIX
18 U.S.C. §§ 1961-1964

§ 1961. Definitions

As used in this chapter—

(1) "Racketeering activity" means (A) any act or threat involving murder, kidnapping, gambling, arson, robbery, bribery, extortion, or dealing in narcotic or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year; (B) any act which is indictable under any of the following provisions of title 18, United States Code: Section 201 (relating to bribery), section 224 (relating to sports bribery), sections 471, 472, and 473 (relating to counterfeiting), section 659 (relating to theft from interstate shipment) if the act indictable under section 659 is felonious, section 664 (relating to embezzlement from pension and welfare funds), sections 891-894 (relating to extortionate credit transactions), section 1084 (relating to the transmission of gambling information), section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), section 1503 (relating to obstruction of justice), section 1510 (relating to obstruction of criminal investigations), section 1511 (relating to the obstruction of State or local law enforcement), section 1951 (relating to interference with commerce, robbery, or extortion), section 1952 (relating to racketeering), section 1953 (relating to interstate transportation of wagering paraphernalia), section 1954 (relating to unlawful welfare fund payments), section 1955 (relating to the prohibition of illegal gambling businesses), sections 2314 and 2315 (relating to interstate transportation of stolen property), sections 2341-2346 (relating to trafficking in contraband cigarettes), sections 2421-24 (relating to white slave traffic), (C) any act which is indictable under title 29, United States Code, section 186 (dealing with restrictions on payments and loans to labor organizations) or section 501(c) (relating to embezzlement from union funds), or (D) any offense, involving fraud connected with a case under title 11, fraud in the sale of securities, or the felonious manufacture, importation,

receiving, concealment, buying, selling, or otherwise dealing in narcotic or other dangerous drugs, punishable under any law of the United States;

(2) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, any political subdivision, or any department, agency, or instrumentality thereof;

(3) "person" includes any individual or entity capable of holding a legal or beneficial interest in property;

(4) "enterprise" includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity;

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity;

(6) "unlawful debt" means a debt (A) incurred or contracted in gambling activity which was in violation of the law of the United States, a State or political subdivision thereof, or which is unenforceable under State or Federal law in whole or in part as to principal or interest because of the laws relating to usury, and (B) which was incurred in connection with the business of gambling in violation of the law of the United States, a State or political subdivision thereof, or the business of lending money or a thing of value at a rate usurious under State or Federal law, where the usurious rate is at least twice the enforceable rate;

(7) "racketeering investigator" means any attorney or investigator so designated by the Attorney General and charged with the duty of enforcing or carrying into effect this chapter;

(8) "racketeering investigation" means any inquiry conducted by any racketeering investigator for the purpose of ascertaining whether any person has been involved in any violation of this chapter or of any final order, judgment, or

decree of any court of the United States, duly entered in any case or proceeding arising under this chapter;

(9) "documentary material" includes any book, paper, document, record, recording, or other material; and

(10) "Attorney General" includes the Attorney General of the United States, the Deputy Attorney General of the United States, any Assistant Attorney General of the United States, or any employee of the Department of Justice or any employee of any department or agency of the United States so designated by the Attorney General to carry out the powers conferred on the Attorney General by this chapter. Any department or agency so designated may use in investigations authorized by this chapter either the investigative provisions of this chapter or the investigative power of such department or agency otherwise conferred by law.

§ 1962. Prohibited activities

(a) It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern of racketeering activity of the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

(b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsections (a), (b), or (c) of this section.

§ 1963. Criminal penalties

(a) Whoever violates any provision of section 1962 of this chapter shall be fined not more than $25,000 or imprisoned not more than twenty years, or both, and shall forfeit to the United States (1) any interest he has acquired or maintained in violation of section 1962, and (2) any interest in, security of, claim against, or property or contractual right of any kind affording a source of influence over, any enterprise which he has established, operated, controlled, conducted, or participated in the conduct of, in violation of section 1962.

(b) In any action brought by the United States under this section, the district courts of the United States shall have jurisdiction to enter such restraining orders or prohibitions, or to take such other actions, including, but not limited to, the acceptance of satisfactory performance bonds, in connection with any property or other interest subject to forfeiture under this section, as it shall deem proper.

(c) Upon conviction of a person under this section, the court shall authorize the Attorney General to seize all property or other interest declared forfeited under this section upon such terms and conditions as the court shall deem proper. If a property right or other interest is not exercisable or transferable

for value by the United States, it shall expire, and shall not revert to the convicted person. All provisions of law relating to the disposition of property, or the proceeds from the sale thereof, or the remission or mitigation of forfeitures for violation of the customs laws, and the compromise of claims and the award of compensation to informers in respect of such forfeitures shall apply to forfeitures incurred, or alleged to have been incurred, under the provisions of this section, insofar as applicable and not inconsistent with the provisions hereof. Such duties as are imposed upon the collector of customs or any other person with respect to the disposition of property under the customs laws shall be performed under this chapter by the Attorney General. The United States shall dispose of all such property as soon as commercially feasible, making due provision for the rights of innocent persons.

§ 1964. Civil remedies

(a) The district courts of the United States shall have jurisdiction to prevent and restrain violations of section 1962 of this chapter by issuing appropriate orders, including, but not limited to: ordering any person to divest himself of any interest, direct or indirect, in any enterprise; imposing reasonable restrictions on the future activities or investments of any person, including, but not limited to, prohibiting any person from engaging in the same type of endeavor as the enterprise engaged in, the activities of which affect interstate or foreign commerce; or ordering dissolution or reorganization of any enterprise, making due provision for the rights of innocent persons.

(b) The Attorney General may institute proceedings under this section. In any action brought by the United States under this section, the court shall proceed as soon as practicable to the hearing and determination thereof. Pending final determination thereof, the court may at any time enter such restraining orders or prohibitions, or take such other actions, including the acceptance of satisfactory performance bonds, as it shall deem proper.

(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue

therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

(d) A final judgment or decree rendered in favor of the United States in any criminal proceeding brought by the United States under this chapter shall estop the defendant from denying the essential allegations of the criminal offense in any subsequent civil proceeding brought by the United States.

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83-539

Nos.

IN THE

Supreme Court of the United States

October Term, 1983

No.

ARTHUR ANDERSEN & CO.,
COOPERS & LYBRAND,
ALEXANDER GRANT & COMPANY,
SOCIETE COMMERCIALE DE REASSURANCE and
SCOR REINSURANCE COMPANY,
Petitioners,

v.

JAMES W. SCHACHT, the Acting Director
of Insurance of the State of Illinois and
Liquidator of Reserve Insurance Company,
Respondent.

No.

ISIDORE BROWN, ROGER O. BROWN, JULES DASHOW,
WALTER Y. ELISHA, NORMAN M. GOLD, JERROLD N. FINE,
BURTON I. KOFFMAN, ANTHONY M. TORTORIELLO,
HUGO UYTERHOEVEN, WALLACE J. STENHOUSE, JR.,
DONALD J. CLARKIN, STANTON I. SUBECK,
JOHN W. MULDOON and MICHAEL L. MEYER,
Petitioners,

v.

JAMES W. SCHACHT, the Acting Director
of Insurance of the State of Illinois and
Liquidator of Reserve Insurance Company,
Respondent.

APPENDIX TO PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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TABLE OF CONTENTS

Page

APPENDIX A:

Opinion of Court of Appeals, dated April 8, 1983 ..... 1a

APPENDIX B:

Order of Court of Appeals Dated July 1, 1983, Denying Petitions For Rehearing And Suggestion For Rehearing *En Banc* and Amending Opinion 1b

APPENDIX C:

Decision on Pending Motions by the District Court, dated January 21, 1982 ..... 1c

APPENDIX D:

Order of Certification by the District Court, dated April 30, 1982.... 1d

APPENDIX E:

Judgment of the Court of Appeals, dated April 8, 1983 ..... 1e

APPENDIX F:

Complaint 1f

APPENDIX A

In the

United States Court of Appeals

For the Seventh Circuit

Nos. 82-2088, 82-2089, 82-2090

JAMES W. SCHACT, the Acting Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company,

Plaintiff-Appellee,

v.

ISADORE BROWN, et al.,

Defendants-Appellants.

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 81 C 1475—Thomas R. McMillen, *Judge.*

ARGUED DECEMBER 10, 1982—DECIDED APRIL 8, 1983

Before CUMMINGS, *Chief Judge*, WOOD, *Circuit Judge*, and HOFFMAN, *Senior District Judge.**

WOOD, *Circuit Judge*. This is an interlocutory appeal from the district court's order denying defendants' motion to dismiss the complaint; it was certified to this court for resolution of controlling questions of law, pursuant to 28 U.S.C. § 1292(b). While the district court did not limit its certification to a particular question, it stated that it viewed the "controlling question" to be

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* The Honorable Walter Hoffman, Senior District Judge of the Eastern District of Virginia, is sitting by designation.

whether the plaintiff may sue for the type of injury he alleges here under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 (hereinafter, RICO). In order to reach this jurisdictional issue, however, we find it first necessary to determine the standing of the plaintiff, the Director of Insurance of the State of Illinois (Director), who is the statutory liquidator of Reserve Insurance Company (Reserve), to maintain the action, and to determine the sufficiency of the complaint. We conclude that the Director has standing, that his complaint is sufficient, and that it alleges an injury which may be redressed by a civil action under RICO.

I. *Factual Background*

Although the alleged events giving rise to this action are complex, they may be outlined briefly for the purposes of this appeal. The main focus of the allegations is that, as a result of the fraudulent actions of the various defendants, Reserve's corporate parent was caused to continue Reserve in business even though the latter was insolvent, and was caused to saddle Reserve with additional liabilities and drive it deeper into insolvency, all of which consequences resulted in damage to Reserve, as well as its policyholders and creditors, exceeding $100,000,000.

The complaint recites that, as of December 31, 1974, Reserve was insolvent as a result of its policy of accepting extraordinarily high-risk insurance business and underreserving and maintaining insufficient surplus for potential claims. In late 1974, the Director alleges, the Illinois Department of Insurance became concerned about the diminution of Reserve's surplus, and initiated negotiations with the officers and directors of Reserve and American Reserve Corporation (ARC), Reserve's corporate parent, to rectify the problem. While these negotiations were proceeding, however, the officers and directors of Reserve and ARC caused their companies to enter into an agreement with defendants Societe Commerciale De Reassurance (SCOR), a deal brokered by

SCOR Reinsurance Company (SCOR Re). Under the terms of this agreement, Reserve ceded to SCOR most of its more profitable and least risky business (in return for SCOR's payments of commissions to Reserve), most of which business SCOR in turn secretly retroceded to another ARC subsidiary, Guarantee Reserve Co., Ltd. (GRC). Also, because the capitalization of GRC was insufficient to cover the potential losses involved in this retrocession, the Director alleges, ARC's officers and Directors secretly agreed to guarantee GRC's obligations to SCOR. The purpose of these agreements, the Director charges, was to enable Reserve to report on paper a smaller volume of business and an increase in surplus and thus a lower liability-to-surplus ratio, a fraudulent result which concealed and exacerbated Reserve's actual insolvency.

By concealing Reserve's continued liability for the retroceded business and hence Reserve's continued insolvency, the Director alleges, the defendant directors and officers were able to fraudulently obtain approval of the Illinois Department of Insurance for the cession agreements and were able to reach a consent agreement with the Department in April, 1975 which enabled Reserve to continue operations if certain surplus requirements were met. In addition, the subsequent continuation of these concealments effected through the SCOR agreements enabled Reserve's officers to violate the explicit surplus maintenance requirements of the consent agreement, the Director avers, while the SCOR agreements had the further cumulative effect of draining away from Reserve its more profitable and less risky business and over $3,000,000 in income. If the Department had at any time known of Reserve's actual insolvency, the complaint charges, it would not have permitted Reserve to continue to write insurance and suffer further dissipation of its assets, but would have caused Reserve to stop writing insurance pursuant to Ill. Rev. Stat., ch. 73, § 756.1 (1981). The complaint alleges that defendants SCOR and SCOR Re were aware of the fraudulent purposes (and the further crippling impact upon Reserve) of the underlying agreements which they entered into

and brokered. The director further alleges that the defendant accounting firms, Coopers and Lybrand, Alexander Grant and Co., and Arthur Andersen and Co., knew of Reserve's insolvency and of the further impairing effect of the SCOR agreements and Reserve's continued operations, but that, despite this knowledge, each of them prepared unqualified opinion letters as to ARC's consolidated financial statements in 1974, 1975, 1976 and 1977, even though those statements failed to disclose that the SCOR agreement was entered into to conceal Reserve's insolvency, that the SCOR agreement did not remove any substantial risk of loss from Reserve and ARC, that the SCOR arrangement had been used to evade the consent agreement, that Reserve was at all times insolvent, and that the SCOR arrangement resulted in the multiplication of Reserve's high risk business while draining it of its least risky and most profitable business. In short, the Director claims that SCOR, SCOR Re and the accounting firm defendants joined with ARC and Reserve's officers and directors in a multifaceted, fraudulent scheme which kept Reserve operating long past insolvency in a manner which resulted in enormous losses to the latter company.

In 1979, Reserve was finally adjudicated insolvent and the Director was designated as the Liquidator of Reserve pursuant to Ill. Rev. Stat., ch. 73, §§ 799 *et seq.* (1981). Under that statute, the Director is vested with all rights of action belonging to Reserve. Ill. Rev. Stat., ch. 73, § 805 (1981). Pursuant to that mandate, the Director filed this action in district court in 1981, seeking relief for damages sustained by Reserve as a result of the alleged fraudulent scheme under RICO and a variety of Illinois statutory and common law theories. In January, 1982, the district court granted the defendants' motion to dismiss fifteen pendant state law claims, but denied their motion to dismiss Counts II and IV, seeking relief under RICO, and Counts I and III, alleging and seeking relief for damages resulting from a criminal conspiracy under Illinois law.

After discovery had commenced, the district court denied defendants' motion to reconsider, but certified its

order to this court for an interlocutory appeal; we thereafter granted defendants' petition for interlocutory appeal. The defendants' chief contention on appeal is that the district court lacks jurisdiction over the present matter because Reserve's injuries as alleged in Count II and Count IV of the Director's complaint are not actionable under RICO's civil damage provision, 18 U.S.C. § 1964(c), but some of the defendants also argue that, even assuming that RICO applies, the Director still lacks standing to maintain the present action, and that in any event the Director's complaint insufficiently invokes the formal elements of a RICO claim. We first address the defendant's standing arguments, and then consider defendants' RICO-related contentions.

II. *The Director's Standing: Capacity and Equitable Estoppel*

RICO considerations aside, defendants Grant, Coopers and Lybrand, Arthur Andersen, and SCOR and SCOR Re argue that the Director either lacks standing *ab initio* to maintain the present action or is estopped from doing so.[1] Their main argument proceeds in two stages. First, they note, the Director as Liquidator acquires only those rights of action that would accrue to Reserve itself; the Director may not assert the legal claims of Reserve's policyholders or creditors. As the next step, they argue that since the Director admits that Reserve's officers and directors instigated the illegal conduct here, the Director, standing in the shoes of Reserve, is estopped[2] from proceeding against the extra-corporate

[1] The other defendants, directors and officers of Reserve and ARC, do not challenge in their brief on appeal the Director's right to proceed against them on any basis other than RICO.

[2] Some defendants have also characterized this procedural bar as a substantive one, arguing that the complaint must fail because its facts demonstrate that the Director will be unable to demonstrate *causation* of fraud, given the corporation's imputed knowledge. Because both characterizations raise the same issue, both will be dealt with under the "estoppel" heading.

confederate defendants under our decision in *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449 (7th Cir. 1982). SCOR and SCOR Re argue additionally that, *Cenco* considerations aside, prevailing law does not permit an insurance liquidator to pursue on behalf of the corporation he represents claims for losses stemming from the artificially and fraudulently prolonged life of the corporation and its consequent dissipation of assets.

Even accepting the first step of the defendants' argument,[3] *i.e.*, that the Director may prosecute only those

[3] Although we need not reach the question for the purpose of this appeal, we note our agreement with the proposition that the Director may pursue no action which could not have been asserted directly by Reserve before liquidation. This conclusion is supported first by the plain text of the statute which provides that the Director as Liquidator "shall be vested by operation of law with the title to all property, contracts and *rights of action of the company* as of the date of the order . . . directing liquidation." Ill. Rev. Stat., ch. 73, § 805 (emphasis added).

Second, a century of interpretation of this and its predecessor provisions has established the basic rule that "where a receiver is appointed for the purpose of taking charge of the property and assets of a corporation, he is, for the purpose of determining the nature and extent of his title, regarded as representing only the corporate body itself, and not its creditors or shareholders. . . . [H]e takes only the rights of the corporation such as could be asserted in its own name, and that upon that basis, only, can he litigate for the benefit of other shareholders or creditors." *Republic Life Insurance Co. v. Swigart*, 135 Ill. 150, 167, 25 N.E. 680 (1890); *People ex rel. Barret v. Bank of Peoria*, 295 Ill. App. 543, 549, 15 N.E.2d 333, 335-36 (1938); *Sangamon Loan & Trust Co. v. People's Savings Bank & Trust Co.*, 204 Ill. App. 7, 14 (1917); *Golden v. Cervenka*, 278 Ill. 409, 437, 116 N.E. 273, 284 (1917); *see also* 19 Appleman, Insurance Law and Practice, § 10682 at 122, 123 (1982); 2 Couch on Insurance 2d, § 22:48 (1959). A narrow exception to this rule has been permitted where, unlike here, the receiver sues to recover on behalf of a plaintiff's creditors a specific asset from a defendant who has, with the knowledge of the plaintiff's corporate officials, misrepresented its existence. *Sangamon*, 124 Ill. App. at 14; *Golden*, 278 Ill. at 427; *see also Wheeler v. American National Bank*, 347 So. 2d 918, 925

(Footnote continued on following page)

legal actions available to the corporate body, we disagree with the defendants' contention that *Cenco* applies to the instant case, or that, even if it does apply, its underlying policy forbids the Director from maintaining the present action on behalf of Reserve. In addition, we reject SCOR and SCOR Re's fallback position that Reserve lacks standing to sue, either derivatively or through a receiver, to recover damages resulting from the fraudulently extended life of the corporation and its concomitant dissipation of assets.

Our reasons for finding *Cenco* inapplicable to the estoppel issue in the present case are twofold. First, the main controverted claim in *Cenco* arose under Illinois common law, and therefore this court's analysis of circumstances under which the knowledge of fraud on the part of the plaintiff's directors be imputed to the plaintiff corporation were merely an attempt to divine how Illinois courts would decide that issue. *Cenco*, 868 F.2d at 455. By contrast, the cause of action here arises under RICO, a federal statute; we therefore write on a clean slate and may bring to bear federal policies in deciding the estoppel question.

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[3] *continued*

(Tex. 1961); *Magnusson v. American Allied Insurance Co.*, 290 Minn. 465, 189 N.W.2d 28, 33 (1971). *Bonhiver v. Graff*, 311 Minn. 111, 248 N.W.2d 291 (1976) and *McTamany v. Day*, 23 Idaho 95, 128 P. 563 (1912), cited by the Director, are distinguishable. The statute involved in *Bonhiver*, Minn. Stat. Ann. § 60 B. 25 (13), authorized the liquidator to assert claims of creditors and policyholders, while in *McTamany*, the court held only that the receiver could proceed on behalf of creditors and policyholders against the insolvent company's directors, not extracorporate parties. *McTamany*, 128 P. at 565. In any event, to the extent that either of these cases can be read to authorize an insurance liquidator to pursue claims more extensive than those accruing to the corporation itself, they conflict with the clear rule fashioned by the Illinois courts and the leading authorities. It is therefore incumbent upon this court not to effect innovation in what appears to be settled state law. *Murphy v. White Hen Pantry Co.*, 691 F.2d 350, 355 (7th Cir. 1982).

Second, even if the estoppel holding in *Cenco* were relevant to a RICO claim, an important prerequisite for its invocation in the present case is lacking. The *Cenco* court limited its estoppel analysis to cases where "the managers are not stealing from the company . . . but instead are turning the company into an engine of theft against outsiders." *Cenco*, 686 F.2d at 454. As the court explained,

> Fraud on behalf of a corporation is not the same theory as fraud against it. Fraud against the corporation usually hurts just the corporation; the stockholders are the principal if not only victims. . . . But the stockholders of a corporation whose officers commit fraud for the benefit of the corporation are beneficiaries of the fraud.

Id. at 456. In *Cenco*, this court found that the fraudulent inflation of the corporation's inventories and hence stock prices clearly benefited the corporation to the detriment of outside creditors, stock purchasers and insurers; this fact, in the court's view, made the case ripe for an analysis of whether the directors' knowledge of the fraud should be imputed to the benefited corporation. By contrast, the complaint in the instant case alleges a far-reaching scheme in which, as a consequence of the illegal activities of Reserve's directors and the outside defendants, Reserve was, *inter alia*, fraudulently continued in business past its point of insolvency and systematically looted of its most profitable and least risky business and more than $3,000,000 in income—all actions which aggravated Reserve's insolvency. In no way can these results be described as beneficial to Reserve.[4] *Compare Security American Corp. v. Schacht*,

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[4] These defendants argue that, since Reserve was a wholly-owned subsidiary of ARC, the owners of Reserve, i.e. ARC shareholders, automatically benefited from the direct draining of Reserve and the fraudulent prolongation of Reserve's life. This argument founders on both logic and fact. First, it defies common sense to suggest that a parent corporation's shareholders are not injured when their directors fraudu-

(Footnote continued on following page)

No. 82-C-2132, slip op. at 3, 4 (N.D. Ill. Jan. 31, 1983) ("particular fact pattern" established that plaintiff corporation had been created solely to carry out fraudulent scheme and thus had no other purpose than to be "engine of theft" against outsiders under *Cenco*).

Defendants argue nonetheless that since the alleged fraudulent scheme had the effect of continuing Reserve's active corporate existence past the point of insolvency to the detriment of outside creditors and policyholders, Reserve was *pro tanto* benefited. But the fact that Reserve's existence may have been artificially prolonged pales in comparison with the real damage allegedly inflicted by the diminution of its assets and income. Under such circumstances, the prolonged artificial insolvency of Reserve benefited only Reserve's managers and the other alleged conspirators, not the corporation. *See In re Investor's Funding Corp.*, [1980] Fed. Sec. L. Rep. (CCH) ¶97,696 at 98,655 (1980). More colloquially put, if defendants' position were accepted, the possession of such "friends" as Reserve had would certainly obviate the need for enemies. We do not believe that such a Pyrrhic "benefit" to Reserve is sufficient to even trigger the *Cenco* analysis which seeks to determine the propriety of imputing to the corporation the directors' knowledge of fraud.

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[4] *continued*

lently prop up, drain, and thereby deepen the insolvency of a subsidiary for whose liabilities the shareholders will eventually be liable. The damage resulting to the parent corporation's shareholders is as real as if the management had impaired a valuable working asset or sold it for a meager sum far less than its present value. Second, as a factual matter, the complaint alleges that not all of the proceeds resulting from the crippling of Reserve redounded to the benefit of ARC and ARC's shareholders. According to the allegations, as a result of the SCOR agreements, ARC was secretly exposed to increased liability for GRC's performance; also as part of these agreements, SCOR allegedly received additional payments from ARC in excess of $2,500,000 for its assistance in furthering the scheme.

Even if a *Cenco*-type analysis were applied to the instant case, however, it would not yield the result that defendants urge, *i.e.*, estoppel of the Director based on the imputation to Reserve of the directors' knowledge of fraud. In *Cenco*, we undertook a two-pronged analysis to determine whether such imputation should occur: whether a judgment in favor of the plaintiff corporation would properly compensate the victims of the wrongdoing, and whether such recovery would deter future wrongdoing. *Cenco*, 686 F.2d at 455. We find that, if warranted by the proof at trial, recovery by the Director on behalf of Reserve would do both.

First, any recovery by the Director from the instant suit will inure to Reserve's estate. And under the distribution provisions of the governing liquidation statute, it is the policyholders and creditors who have first claim (after administrative costs and wages owed) to the assets of the estate. Ill. Rev. Stat., ch. 73, § 817 (1981). Thus, the claims of these entirely innocent parties must be satisfied in full before Reserve's shareholders, last in line for recovery, receive anything.

Moreover, there is no indication here that the Director's success entails the likelihood of the kind of "perverse" compensation pattern which we declined to permit in *Cenco*. In *Cenco*, the court was troubled first by the fact that among the shareholders benefiting from a successful recovery were the corrupt officers themselves, *Cenco*, 686 F.2d at 455; here, the defendants do not claim that the wrongdoing officers or directors hold equity positions in Reserve entitling them to recover from the instant suit. We were also troubled in *Cenco* by the prospect of double recovery by the shareholders via the plaintiff corporation in view of the previous successful recovery of damages by these same shareholders in a direct suit against the defendants. In this case, by contrast, the only action initiated by parties other than the Director noted to this court based on these alleged events, *Huddleston v. American Reserve Corporation*, 79 CH 3717 (pending, Circuit Court of Cook County, Chancery Division), has been stayed, and the Director has suc-

cessfully intervened therein.[5] Of course, if the Director recovers successfully in the instant suit, the defendants in *Huddleston* and the state actions filed by the Director will be able to assert the previous satisfaction of the claims of the policyholders and creditors of Reserve as a bar to subsequent recovery.

Second, from the standpoint of deterrence, this court in *Cenco* based its refusal to permit the plaintiff to recover unimpeded by the directors' knowledge in large part on two circumstances not present here: 1) that the directors, as shareholders, would recover directly from the suit, and, 2) that there existed large corporate shareholders in a position to police the plaintiff's corrupt officers, an activity that would be discouraged by allowing the shifting of corruption-caused loss to outside defendants. *Cenco*, 686 F.2d at 456. By contrast, here, as noted earlier, there is no evidence that the wrongdoing officers of Reserve would benefit directly from the instant suit. There is also no evidence here of the existence of large corporate shareholders capable of conducting an independent audit, as in *Cenco*, and whose lack of investigatory zeal would be rewarded by a decision favorable to the Director.

The court in *Cenco* also expressed reluctance to permit even innocent, atomized shareholders to recover damages for wrongdoing in which their officers were implicated, but that concern must be viewed against the background of the recovery of many of those same shareholders in an earlier action, and the fact that, suing directly, the full recovery in the later suit would inure to them. Significantly, due to the operation of the liquidation statute here, Reserve's shareholders are last in line for recovery from Reserve's estate and will receive only a residual recovery from the instant suit, if

[5] In oral argument, defendants stated that "numerous other actions," based on these same allegations, have been filed by policyholders and creditors of Reserve. However, the parties have identified to this court no such other cases aside from *Huddleston*.

successful after trial, after all of the policyholders and creditors are compensated in full. Thus, unlike the situation in *Cenco*, permitting recovery in this case would not send unqualified signals to shareholders that they need not be alert to managerial fraud since they may later recover full indemnification for that fraud from third party participants.[6] In sum, we believe not only that *Cenco* is not applicable to the present case, but also that even if it were, application of its compensation and deterrent principles would not inhibit the right of the Director to proceed against the defendants here.

We turn finally to SCOR and SCOR Re's fallback argument that, even if the Director were not barred from proceeding under *Cenco*, the Director still lacks standing to sue on behalf of Reserve. Citing *Bergeson v. Life Insurance Corp.*, 265 F.2d 227 (10th Cir. 1959), *cert.*

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[6] The defendants have argued that, due to the statutory authorization of treble damages in RICO civil actions, Reserve's shareholders will experience an enormous windfall recovery to the extent of the full damage increment exceeding single damages. This is not necessarily the case, however, for under the controlling statute, the shareholders will receive only the last residual of Reserve's *estate*, not a share of each recovery before it is added to that estate. As noted, there are other prior claims on that estate which must be satisfied first, including wages, administration costs, and the claims of policyholders and creditors which may well exceed the amount, or even triple the amount, asserted to have arisen from the damages to the corporation claimed in the present action. Without knowledge of the size of each of these prior claims, evidence of which has not been presented at this stage, we decline to speculate on the existence or relative size of any recovery to Reserve's shareholders.

Moreover, since the deterrence policy of *Cenco* is a forward-looking one, we should apply it with the normal case in mind and not be overly swayed by the fortuity of a treble damage provision which may in some cases result in a large recovery to a plaintiff's shareholders. This is especially so where to hold otherwise, as here, would do immense damage to the policy underlying the statutory liquidation process: the protection of the interests of policyholders, shareholders and creditors jointly by the Director.

denied, 360 U.S. 932 (1959); *Kinter v. Connolly*, 233 Pa. 5, 81 A.2d 905 (1911); *Pattern v. Franklin*, 176 Pa. 612, 35 A. 205 (1896); *Kelly v. Overseas Investors, Inc.*, 18 N.Y.2d 622, 219 N.E.2d 288, 272 N.Y.S.2d 773 (1966); and *Cotten v. Republic National Bank*, 395 S.W.2d 930 (Tex. Civ. App. 1965), these defendants argue that a corporation may never sue to recover damages alleged to have resulted from the artificial prolongation of an insolvent corporation's life. Next, they argue, since Count II and Count IV of the instant complaint assert that "Reserve continued to write insurance" as a result of the underlying mail fraud, and "Reserve's assets were dissipated notwithstanding that Reserve was at all times insolvent," the sole thrust of the Director's complaint is that the damages to Reserve occurred only because Reserve continued to do business past its point of insolvency. Therefore, they conclude, the Director's claim in this case is barred by the general rule prohibiting a corporation from suing for damages caused by the artificial prolongation of its life.

We reject both premises of this argument. First, in the underlying allegations here, the Director charges that the damage to Reserve stemmed not only from the mere extension of the normal business operation of Reserve, but from specific actions crippling Reserve which were taken as an integral part of that extension. *Inter alia*, the Director alleges that with the smokescreen of the underlying mail fraud, Reserve's directors and other defendants were able to drain Reserve of over $3,000,000 of income, and to drain Reserve of its most profitable and least risky business, thereby deepening Reserve's insolvency. Thus, the "asset dissipation" alleged was not only that which resulted from the normal operation of the business, as in the cases cited by the defendants,[7] but also that which resulted from the

[7] In *Kinter v. Connolly*, 233 Pa. 5, 81 A. 905 (1911), for example, the lower court noted specifically that in "the bill before us . . . there is no averment that any act or omission of the defendants . . . caused loss or injury to the company." 81 A. at 905.

bleeding of Reserve which was a part of the underlying scheme to defraud.

Alternatively, to the extent that the cited cases suggest that a corporation may not sue to recover damages resulting from the fraudulent prolongation of its life past insolvency, we decline to speculate that the Illinois courts would accept this restriction on the Director's freedom of action. For each of these cases rests upon a seriously flawed assumption, *i.e.*, that the fraudulent prolongation of a corporation's life beyond insolvency is automatically to be considered a benefit to the corporation's interests. *See, e.g., Bergeson*, 265 F.2d at 232; *Kinter*, 81 A. at 905; *Patterson*, 35 A. at 206. This premise collides with common sense, for the corporate body is ineluctably damaged by the deepening of its insolvency, through increased exposure to creditor liability. *See In Re Investor's Funding Corp.*, [1980] Fed. Sec. L. Rep. (CCH) ¶97,696, at 98,655 (S.D.N.Y. 1980). Indeed, in most cases, it would be crucial that the insolvency of the corporation be disclosed, so that shareholders may exercise their right to dissolve the corporation in order to cut their losses. *See* Ill. Rev. Stat., ch. 32, §§ 157.75, 157.76 (1981). Thus, acceptance of a rule which would bar a corporation from recovering damages due to the hiding of information concerning its insolvency would create perverse incentives for wrong-doing officers and directors to conceal the true financial condition of the corporation from the corporate body as long as possible. We are not prepared to conclude that the Illinois courts would adopt such a regime.

III. *The Applicability of RICO*

We turn now to defendants' contentions that the injury to Reserve which the Director alleges is not compensable under RICO. The civil damage provision of RICO, 18 U.S.C. § 1964(c), creates a private right of action with treble damage recovery for "[a]ny person injured in his business or property by reason of a violation of [§ 1962]." Section 1962 enumerates two violations relevant to the instant case: § 1962(a) makes it "unlaw-

ful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity . . . to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or establishment or operation of, any enterprise" which touches interstate commerce; and § 1962(c) makes it "unlawful for any person employed by or associated with any enterprise [engaged in interstate commerce] to conduct or participate directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity. . . ." Finally, RICO § 1961 defines a "pattern of racketeering activity" as at least two occurrences within ten years of any of several predicate offenses, including mail fraud.

In his complaint, the Director alleges that injury to Reserve stemmed from the violation by the defendants of both § 1962(a) and § 1962(c). The underlying "pattern of racketeering activity" alleged consists of the mail fraud which occurred in connection with the mailing of the fraudulent financial statements of Reserve which all defendants knew did not disclose Reserve's insolvency or the purpose and effects of the SCOR deal. Count II of the complaint alleges that the officers and directors, SCOR and SCOR Re used income derived from the pattern of racketeering activity in the operation of their businesses in violation of § 1962(a), and that the same defendants conducted the affairs of ARC, SCOR, and SCOR Re through the underlying pattern of racketeering activity, in violation of § 1962(c). Count IV alleges that the officers and directors and the three defendant accounting firms used income derived from the racketeering activity in the operation of ARC and the accounting firms in violation of § 1962(a), and that the officers and directors and the accounting firms conducted the affairs of ARC and the accounting firms through a pattern of racketeering activity in violation of § 1962(c).

Because each of the described violations amount to alternative characterizations of the same conduct, *i.e.*, the cooperation of the defendants in a scheme which

impaired Reserve, we can find that RICO applies if any one of the Director's theories is sufficient to invoke the statute. Indeed, we find, after careful consideration, an adequate description of a compensable civil RICO claim in the portions of Counts II and IV of the complaint which allege injury to Reserve as a result of the defendants' direct or indirect participation in the conduct of ARC's affairs through the alleged mail fraud in such a manner as to artificially prolong Reserve's existence and worsen its insolvency and losses.

The defendants contend that numerous fatal defects inhere in these portions of the Director's complaint. First, they argue that the complaint itself is technically insufficient on its face by failing to explicitly allege that all of the defendants participated in the conduct of ARC and by failing to allege that Reserve's injury occurred as a result of the *operation of ARC* through the underlying mail fraud. Second, and more generally, they argue that Congress did not intend that the civil provisions of RICO would be applicable to the general universe of business fraud encompassing the acts alleged here. Third, the defendants argue that the proper causational predicates for the invocation of § 1964(c) are not present here; recovery, they aver, may only follow a showing that the plaintiff suffered "competitive" rather than "direct" injury from the defendants' actions, and, in any case, they maintain, there is a failure to allege that *any* injury to Reserve stemmed from the operation of ARC through the mail fraud. Finally, the accounting firm defendants, SCOR and SCOR Re argue several miscellaneous theoretical insufficiencies in the Director's complaint: no recovery is possible by Reserve, the "perpetrator" of the fraud, against Reserve's "unwitting tools," under our decision in *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449 (7th Cir. 1982); the accountants, SCOR and SCOR Re were not sufficiently "employed by or associated with" ARC; and SCOR and SCOR Re could not have been culpable of the alleged underlying mail fraud. We shall consider each of these arguments *seriatim*.

A. *Technical Sufficiency of the Complaint*

The defendants first insist that, even were the theoretical hurdles to RICO coverage cleared, the Director's complaint does not recite coherently an underlying violation of § 1962(c) or injury stemming therefrom. We find that these arguable technical insufficiencies inhere only in the cumulative and summary portions of the complaint, and that the Director's basic theory is supported by the complaint's full factual allegations. In examining the complaint, we are guided by the principle that the "liberal pleading policy of the [Federal Rules of Civil Procedure] prevents dismissal of a meritorious action for purely formal or technical reasons," *Murphy v. White Hen Pantry Co.*, 691 F.2d 350, 353 (7th Cir. 1982), and that we are to construe the pleadings in the plaintiff's favor, *Schnell v. City of Chicago*, 407 F.2d 1084, 1086 (7th Cir. 1969).[8] Moreover, this court may

[8] The defendants argue that there is no place in the instant appeal for application of the liberal pleading policy embodied in *Murphy v. White Hen Pantry Co.* and *Conley v. Gibson*, 355 U.S. 41 (1955), because the basic question to be decided here concerns the alleged absence of federal jurisdiction, and not a 12(b)(6)—related challenge to the sufficiency of the complaint. However, the liberal construction policy of Fed. R. Civ. P. 8(f) is not limited to the context of 12(b)(6) motions. Moreover, although this case is not formally an appeal of denial of a 12(b)(6) motion, the defendants' assault on the technical adequacy of the complaint raises the identical issue involved in such an appeal; we therefore find it appropriate to seek guidance from precedents addressing that procedure.

The defendants argue that liberal construction and amendment of the Director's complaint is especially inappropriate here because the latter was admonished in proceedings below to make sure that its pleadings were sufficient before the appeal was certified. The Director declined to do so, but only in the face of statements by some of the defendants that they would object to such an attempt to amend the complaint, and that, in any case, their primary challenge to the Director's complaint was that no set of facts describing the alleged events, however arranged, could support the invocation of RICO. We also take note of the extraordinary conceptual disarray and schism even among district courts in this circuit,

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grant leave to amend the complaint to correct even substantive errors in the pleadings where this would facilitate a decision on the merits and no prejudice would ensue to the defendants. 3 J. Moore, Moore's Fed. Practice ¶¶15.08, 15.10 (2d ed. 1976); Wright and Miller, Federal Practice and Procedure, §§ 1474, 1487 (1977).

The first arguable technical deficiency in the complaint concerns the statements in paragraphs 81 and 98 that Reserve was damaged "[a]s a direct result of the intentional scheme to defraud, the use of the United States mails in its furtherance and the above described pattern of racketeering activity. . . ." This statement, defendants argue, fails to meet the requirement that RICO damages must be alleged to have occurred "by reason of" the *conduct* of an *enterprise* through a pattern of racketeering activity, not by reason of the underlying racketeering activity itself. But a natural, let alone liberal, reading of the complaint reveals it to be in full conformance with RICO's requirements. For the "intentional scheme to defraud" (the source of the injury) is defined at paragraphs 73 and 90 precisely as the above "conspiracy" set forth in the extensive prefatory factual allegations; that "conspiracy" describes precisely those aspects of the *operation* of ARC and Reserve's affairs made possible "through" the SCOR agreement and the cover-up of Reserve's insolvency. Indeed, it is ARC's operation in such a manner as to artificially prolong the operation of Reserve, not the mail fraud itself, which is separately underscored by the Director as the gravamen of the complaint. *See* paragraphs 41, 43, 44, 57 (realleged at ¶72 (Count II) and ¶89 (Count IV)). Thus, we find that the causal nexus as alleged easily satisfies the requirements of § 1964(c). However, to clarify the com-

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[8] *continued*
discussed *infra*, as to the proper elements of a RICO pleading. Under these circumstances, we decline to penalize the Director for failing to state the summary portions of his RICO allegation with technical precision, especially where his preceding factual allegations amply support on their face a proper RICO claim.

plaint and eliminate any possible misunderstanding, the district court may grant leave to amend the complaint to meet the problems discussed above.

The second technical deficiency in the complaint is the phrasing of the paragraphs in Count II and Count IV charging a violation of § 1962(c):

> The officers and directors, SCOR, SCOR Reinsurance . . . [Anderson, Coopers and Grant] conducted the affairs of ARC, SCOR, SCOR Reinsurance . . . [Anderson, Coopers and Grant] *respectively*, through the pattern of racketeering activity . . . in violation of 18 U.S.C. § 1962(c). (emphasis added).

While it is true that these cumulative paragraphs, taken in themselves, state that only the *officers and directors* conducted the affairs of ARC, there are ample factual allegations, realleged in Counts II and IV, describing the participation of SCOR, SCOR Re and the accountant defendants in the conduct of ARC. *See* paragraphs 29, 30, 33, 34, 37, 42, 44, 49, 49.1, 52, 53, 54. Whether these allegations are sufficient to allege a RICO violation as a policy matter is discussed *infra*, but here we note only that a reading of the full face of the complaint, rather than just the technically insufficient cumulative paragraph, discloses that the Director has alleged conduct which will at least arguably satisfy § 1962(c). Since it therefore does not appear "beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief," *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957) (footnote omitted), we cannot dismiss the complaint on the basis of this deficiency. However, to help clarify the complaint, the district court may grant leave to amend paragraphs 79 and 96 in Counts II and IV to specify the participation of *all* of the defendants in the conduct of ARC's affairs, in conformance with the numerous preceding allegations.[9]

[9] Not only did the existence of these numerous paragraphs detailing the defendants' participation in ARC's affairs give notice to the defendants of the Director's § 1962 theory, but

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B. *The Application of RICO to Business Fraud*

The defendants' main line of attack upon the Director's complaint is that, while it alleges conduct to which RICO might literally apply, Congress did not intend that the statute would reach so far. To allow the Director's complaint to proceed, they argue, would be to unreasonably federalize the common law of "garden variety" business fraud, and eclipse the federal securities laws, providing treble damage actions for all securities-related mail fraud. We agree that the civil sanctions provided under RICO are dramatic, and will have a vast impact upon the federal-state division of substantive responsibility for redressing illegal conduct, but, like most courts who have considered this issue, we believe that such dramatic consequences are necessary incidents of the deliberately broad swath Congress chose to cut in order to reach the evil it sought; we are therefore without authority to restrict the application of the statute. *United States v. Turkette*, 452 U.S. 576, 587 (1981); *United States v. Aleman*, 609 F.2d 298, 303-04 (7th Cir. 1979); *Bennett v. Berg*, 685 F.2d 1053, 1064 (8th Cir. 1982), *pet. for reh. en banc granted*, Sept. 17, 1982.

We begin our analysis with the plain language of the statute, which provides that "any person" may be liable for a violation of §1962(c). "Person" is defined at §1961(3) as "any individual or entity capable of holding a legal or beneficial interest in property. . . ." It does not appear that any of the defendants seriously argue that we should impose a further gloss on that definition requiring that the "person" be affiliated with "organized crime." Such an argument would, of course, be unavailing in light of the clear decisions of this and other courts that application of § 1962(c) "is not restricted to members of organized crime." *Cenco, Inc. v. Seidman &*

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[9] *continued*

also any arguable prejudice resulting from an amendment would be minimal in view of the preliminary status of the case at present. Wright and Miller, Federal Practice and Procedure, § 1487 (1971).

Seidman, 686 F.2d 449, 557 (7th Cir. 1982); *United States v. Aleman*, 609 F.2d 298, 303 (7th Cir. 1979); *Bennett v. Berg*, 685 F.2d 1053, 1063 (8th Cir. 1982), *pet. for reh. en banc granted*, Sept. 17, 1982; *Hanna v. Norcen Energy Resources Ltd.* [Current] Fed. Sec. L. Rep. (CCH) ¶ 98,742 at 93,738 (N.D. Ohio 1982); *Lode v. Leonardo*, No. 82 C 4122 (N.D. Ill. Oct. 12, 1982); *D'Iorio v. Adonizio*, C.A. No. 82-0735 (M.D. Pa. Dec. 30, 1982); *Hellenic Lines, Ltd. v. O'Hearn*, 523 F.Supp. 244, 247 (S.D.N.Y. 1981); *Engl v. Berg*, 511 F.Supp. 1146, 1155 (E.D. Pa. 1981); *Parnes v. Heinhold Commodities*, 487 F. Supp. 645, 646 (N.D. Ill. 1980); *United States v. Gibson*, 486 F. Supp. 1230, 1240-41 (S.D. Ohio 1980); *United States v. Chovane*, 467 F. Supp. 41, 44-45 (S.D.N.Y. 1979). *See also* Strafer, Massumi & Skolnick, *Civil RICO in the Public Interest: "Everybody's Darling,"* 19 Am. Crim. L. Rev. 655, 665-88 (1982). Note, *Civil RICO: The Temptation and Impropriety of Judicial Restriction*, 95 Harv. L. Rev. 1101, 1106-09 (1982); Comment, *Reading the "Enterprise" Element Back into RICO Sections 1962 and 1964(c)*, 76 N.W. U. L. Rev. 100, 100-01 & n.4 (1982). *But see Moss v. Morgan Stanley, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,045 at 94,982 (S.D.N.Y. 1983); *Wagner v. Bear, Stearns and Co., Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,032 at 94,913 (N.D. Ill. 1982); *Adair v. Hunt International Resources Corp.*, 526 F. Supp. 736, 746-48 (N.D. Ill. 1981); *Waterman Steamship Corp. v. Avondale Shipyards, Inc.*, 527 F. Supp. 256, 260 (E.D. La. 1981); *Barr v. WUI/TAS, Inc.*, 66 F.R.D. 109, 113 (S.D.N.Y. 1975). Nonetheless, defendants argue, the use of civil RICO suits against business fraud, such as that alleged here, would duplicate existing state law and federal securities law remedies, would not further the purposes of the Act, and was not within the contemplation of Congress.

The chief problem with this argument is that Congress was well aware of the range of application au-

thorized by RICO's capacious statutory language.[10] But Congress was equally adamant that the fight against organized criminal social exploitation not be impeded by an overly narrow definition of actionable conduct.[11] Congressman Poff, a sponsor of the bill, defended the broad reach of the act by noting,

> The curious objection has been raised to [RICO's provisions] that that they are not somehow limited to organized crime—as if organized crime were a precise and operative legal concept, like murder, rape or robbery. Actually, of course, it is a functional concept like white-collar or street crime serving simply as a shorthand method of referring to a large and varying group of individual criminal offenses committed in diverse circumstances.[12]

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[10] As Representative Mikva noted in House debate,

> My objection to the bill in toto is that whatever its motives to begin with, we will end up with cases involving all kinds of things not intended to be covered, and a potpourri of language by which you can parade all kinds of horribles of overreach . . . under the definition if five or more of [my colleagues] engage in . . . a game of poker and it lasts past midnight . . . thus continuing for a period of two days, then [they] have been running an organized gambling business and [they] can get 20 years, and the Federal Government can grab off the pot besides.

116 Cong. Rec. at 35,204 (1970).

Similar objections were voiced by civil liberties groups, fearing overbroad application. *See* Measures Relating to Organized Crime: Hearings on S. 30, S. 974, S. 975, S. 976, S. 1623, S. 1624, S. 1861, S. 2022, S. 2122 and S. 2292, before the Subcommittee on Criminal Laws and Procedure of the Senate Committee on the Judiciary, 91st Cong., 1st Sess. at 475 (1969).

[11] *See, e.g.*, 116 Cong. Rec. 601 (1970) (statement by Sen. Hruska, outlining problem in demonstrating connections between abhorred activity and formal criminal syndicates).

[12] 116 Cong. Rec. at 35,344.

And as Senator McClellan conceded, "Of course, it is true that Title X will have some application to individuals who are not themselves members of La Cosa Nostra or otherwise engaged in organized crime. However, that is not a reason to cut back its scope. . . ."[13] Later, he noted that "the Senate report does not claim . . . that the listed offenses are committed *primarily* by members of organized crime, only that these offenses are characteristic of organized crime."[14] In short, Congress chose to provide civil remedies for an enormous variety of conduct, balancing the need to redress a broad social ill against the virtues of tight, but possibly overly astringent, legislative draftsmanship. It is not for this court to reassess the balance struck.

That deference to the conscious assessment of Congress should be our guiding principle is made especially clear upon examination of the defendants' specific objection that our reading of RICO will unreasonably eclipse existing federal civil remedies for securities law violations by providing a treble damage action where two acts of mail fraud accompany the disputed sale or purchase of securities. Defendants' contention proves too much, for such a result is to a degree *explicitly* accomplished, even without the simultaneous presence of mail fraud, by the designation in § 1961 of "fraud in the sale of securities" as a predicate offense giving rise to a civil damage action where an enterprise is operated through such fraud; clearly, such an outcome is not the result of a strained interpretation of RICO, but rather is explicitly mandated. Defendants' objection that our interpretation will unreasonably bring into the federal ambit regulation of common law fraud likewise proves too much, for such a realignment of the federal-state role has already been accomplished in the criminal sphere through the existence of the mail fraud statute itself.

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[13] 116 Cong. Rec. at 18, 945 (1970).

[14] McClellan, *The Organized Crime Act or Its Critics: Which Threatens Civil Liberties?*, 46 Notre Dame Law Rev. 55, 142 (1970).

Moreover, the defendants, in raising the spectre of the opening of the litigation floodgates, overlook the fact that neither common law fraud nor securities law violates will, by themselves, be automatically eligible for redress through a civil RICO action; there is the additional requirement under § 1964(c), discussed *infra*, that an interstate enterprise be conducted "through" a pattern of such activity.

In sum, defendants' profession of alarm at the expansion of federal jurisdiction over business fraud through RICO amounts to nothing less than a dispute with the very design, and not the mere application, of the statute. As the Supreme Court has noted in the criminal context,

> [T]he language of the statute and its legislative history indicate that Congress was well aware that it was entering a new domain of federal involvement through the enactment of this measure. Indeed, the very purpose of the Organized Crime Control Act of 1970 was to enable the Federal Government to address a large and seemingly neglected problem. The view was that existing law, state and federal, was not adequate to address the problem, which was of national dimensions. That Congress included within the definition of racketeering activities a number of state crimes strongly indicates that RICO criminalized conduct that was also criminal under state law, at least when the requisite elements of a RICO offense are present. As the hearings and legislative debates reveal, Congress was well aware of the fear that RICO would "mov[e] large substantive areas formerly totally within the police power of the State into the Federal realm." [citations omitted] . . . In the face of these objections, Congress nonetheless proceeded to enact the measure, knowing that it would alter somewhat the role of the Federal Government in the war against organized crime and that the alteration would entail prosecutions involving acts of racketeering that are also crimes under state law. There is no argument that Congress acted beyond its power in so

> doing. That being the case, the courts are without authority to restrict the application of the statute.

United States v. Turkette, 452 U.S. at 586, 587 (1981).

In view of this legislative history, it is not surprising that most courts in this and other circuits have had little trouble in entertaining RICO civil actions for damages flowing from the operation by otherwise "legitimate" business people of enterprises through a pattern of mail fraud and securities law violations. *See, e.g., Bennett v. Berg*, 685 F.2d 1053 (8th Cir. 1982), *pet. for reh. en banc granted*, Sept. 17, 1982 (upholding finding that defendant mortgage lender, insurance company, developer, accountants, attorneys and corporate directors caused compensable RICO damages through operation of retirement community through, *inter alia*, mail fraud); *USACO Coal Co. v. Carbomin Energy, Inc.*, 689 F.2d 94 (6th Cir. 1982) (upholding injunction in civil RICO action founded on corporate promoter's breach of fiduciary duty); *Parnes v. Heinhold Commodities, Inc.*, 487 F. Supp. 645 (N.D. Ill. 1980) (RICO action stemming from mail fraud in commodities trading); *Heinhold Commodities, Inc. v. McCarty*, 513 F. Supp. 311 (N.D. Ill. 1979) (commodities fraud); *Hanna v. Norcen Energy Resources, Ltd.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 98,742 (N.D. Ohio 1982) (RICO action against corporation and its investment banking firm upheld); *Engl v. Berg*, 411 F. Supp. 1146 (E.D. Pa. 1981) (upholding action against mortgage company in securities fraud RICO claim); *Spencer Companies v. Agency Rent-A-Car, Inc.*, [1981] Fed. Sec. L. Rep. (CCH) ¶ 98,361 (D. Mass. 1981) (alleged fraud in misleading public statement in corporate takeover actionable under RICO); *Computer Terminal Systems, Inc. v. Gross*, 1982-1 Trade Cas. (CCH) ¶64,531 (E.D.N.Y. 1981) (action against company officers involving kickback scheme). *But see Wagner v. Bear, Stearns and Co., Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 94,032 at 94,913 (N.D. Ill. 1982); *Moss v. Morgan Stanley, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,045 at 94,982 (S.D.N.Y. 1983); *Adair v. Hunt International Resources Corp.*, 527 F. Supp. 736 (N.D. Ill.

1981); *Waterman Steamship Corp. v. Avondale Shipyards, Inc.*, 527 F. Supp. 256 (E.D. La. 1981); *Barr v. WUI/TAS, Inc.*, 66 F.R.D. 109 (S.D.N.Y. 1975).

Another major problem with the sort of judicial pruning of RICO's civil provisions, advocated by defendants, where business fraud is alleged is that there is simply no legitimate principled criterion through which to accomplish this distinction. Presumably, the infiltration of a corporation by an organized crime syndicate and the subsequent commission of fraud which results in the looting of the corporation's assets for the syndicate's benefit would and should form the basis for a legitimate RICO action. But the only way in which to distinguish this case from the commission of "garden variety" fraud by "legitimate" corporate directors and outside corporations and auditors, as here alleged, is the presence of an "organized crime" nexus in the first case. Indeed, most courts have squarely exempted "normal" business or securities fraud-related claims from RICO's coverage have been forced to rely on the already discredited "organized crime" limitation. *See, e.g., Wagner v. Bear Stearns and Co., Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 94,032 at 94,913 (N.D. Ill. 1982); *Moss v. Morgan Stanley, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶99,045 at 94,982-43; *Adair v. Hunt International Resources Corp.*, 526 F. Supp. 736, 747 (N.D. Ill. 1981); *Waterman Steamship Corp. v. Avondale Shipyards, Inc.*, 527 F. Supp. 256, 259 (E.D. La. 1981); *Barr v. WUI/TAS, Inc.*, 66 F.R.D. 109, 112-13 (S.D.N.Y. 1975). Obviously, having already rejected the "organized crime" limitation, *United States v. Aleman*, 609 F.2d at 303; *Cenco, Inc.*, 686 F. 2d at 557, this court does not wish that limitation to be revived under the guise of determining the kinds of activity covered by RICO.

In short, while we are mindful of the jurisprudential maxim that statutes are not to be interpreted woodenly and without regard to their aim, we do not see how any legitimate or principled tailoring of RICO could be effected without impairing the broad strategy embodied in the act. If Congress wishes to avoid the inclusion under RICO's umbrella of "garden variety" fraud claims

involving the operation of enterprises through mail and securities fraud, it may easily do so through removing mail and securities fraud from the list of predicate acts enumerated in § 1961. That is not, however, a program which may be undertaken by this court. *United States v. Turkette*, 452 U.S. 576, 586-87 (1981).

C. *The Requirement of "Competitive" or "Indirect" Injury*

The defendants' next line of attack on the Director's complaint recites that the allegations point to no "competitive injury" to Reserve from the operation of ARC. Citing Congress' concern with the impact of organized crime infiltration upon free competition and the structural similarity of the RICO treble damage provisions to those available under the antitrust laws, the defendants argue that the civil remedy provided in § 1964 to "[a]ny person injured in his business or property" is not available to those who have suffered *directly* through the operation of a business through a pattern of racketeering, but only to those injured as competitors. Since Reserve is not a competitor of ARC, defendants conclude, the former may not invoke § 1964(c).

We note at the outset that the defendants' construction has been accepted by some district courts. *See North Barrington Development, Inc. v. Tanslow*, No. 80 C 26441 (N.D. Ill. Oct. 9, 1980); *Van Schaick v. Church of Scientology of California, Inc.*, 535 F. Supp. 1125 (D. Mass. 1982); *Erlbaum v. Erlbaum* [Current] Fed. Sec. L. Rep. ¶98,772 at 93,922-23 (E.D. Pa. 1982); *Landmark Savings and Loan v. Rhoades*, 527 F. Supp. 206 (E.D. Mich. 1981). But it has been rejected by the greater number of courts and commentators. *See, e.g., Bennett v. Berg*, 685 F. 2d at 1059, *pet. for reh. en banc granted*, Sept. 17, 1982; *D'Iorio v. Adonizio*, C.A. No. 82-0735 (M.D. Pa., Dec. 10, 1982); *Prudential Lines, Inc. v. McKeon*, No. 80 Civ. 5853 (S.D.N.Y. April 21, 1982); *Parnes v. Heinhold Commodities, Inc.*, 487 F. Supp. 645 (N.D. Ill. 1980); *Heinhold Commodities v. McCarty*, 573 F. Supp. 311, 313 (N.D. Ill. 1979); *Hanna Mining Co. v.*

Norcen Energy Resources, Ltd., [Current] Fed. Sec. L. Rep. (CCH) ¶98,742 at 93,737 (N.D. Ohio 1982); *Engl v. Berg*, 411 F. Supp. 1146 (E.D. Pa. 1981); *Hellenic Lines, Inc. v. O'Hearn*, 523 F. Supp. 244, 248 (S.D.N.Y. 1981) ("RICO does not countenance racketeering activity so long as it is done uniformly across competing concerns"); *Spencer Companies, Inc. v. Agency Rent-a-Car, Inc.*, [1981] F. Sec. L. Rep. (CCH) ¶98,361 (D. Mass. 1981); Strafer, Massumi & Skolnick, *Civil RICO in the Public Interest, supra*, at 689-707; Blakely and Gettings, *Racketeer Influenced and Corrupt Organizations (RICO): Basic Concepts— Civil and Criminal Remedies*, 53 Temple L. Q. 1009, 1040-43 (1983); Note, *Civil RICO: The Temptation and Impropriety of Judicial Restriction, supra*, at 1109-1114; *But see* Comment, *Reading the "Enterprise" Element Back into RICO, supra*, at 125-26 (1981). And, we think, rightly so, for such a crabbed interpretation as the defendants offer does not fully credit Congressional intent or fulfill the purposes of RICO.

First, while in enacting RICO Congress expressed its concern that organized crime "interfere[s] with free enterprise," and noted its desire to protect those injured competitively by businesses infused with the gains of racketeering,[15] it also indicated its concern that "organized crime activities in the United States weaken the stability of the Nation's economic system, *harm innocent investors* and competing organizations . . . and undermine the general welfare of the Nation and its citizens."[16] (emphasis added). Rejecting an alternative legislative course which would have involved simply amending the antitrust laws to provide remedies for competitive harm caused by racketeering infiltration,[17] Con-

[15] OCCA Publ. L. No. 91-452, 84 Stat. 922, 923 (1970) (Statement of Findings and Purpose); 116 Cong. Rec. 602 (1970) (statement of Senator Hruska).

[16] Publ. L. No. 91-452, Sec. 1(4), 84 Stat. 922 (1970).

[17] S. 2048, 90th Cong., 1st Sess. (1967), extending the Sherman Act to coverage of organized criminal activity, was left dormant in committee.

gress instead enacted RICO as a separate tool in the fight against organized crime. As noted by the Antitrust Section of the American Bar Association in committee hearings on RICO, the latter course possessed precisely the advantage of allowing for the effectuation of purposes beyond the protection of competition:

> [Some] activities of organized crime in legitimate business may or may not be subject to the antitrust laws. Thus, some extortion tactics and business takeovers by organized crime might not be reached under the antitrust laws, particularly if they affected only the victimized business rather than resulted in a lessening of competition in an entire line of commerce.[18]

In short, RICO was broadly aimed at "striking . . . a mortal blow against the property interests of organized crime." 116 Cong. Rec. 602 (1970) (statement of Senator Hruska). This court is reluctant to undermine that broad mission of RICO by engrafting onto its civil provisions a competitive injury requirement. *See Bennett v. Berg*, 685 F.2d at 1059 ("In a RICO context, there are few countervailing reasons to lessen the impact of RICO remedies by imputing the limitations on standing which apply to antitrust law.").

The structural similarity of the RICO civil damages apparatus to that contained in the antitrust laws does not persuade us otherwise. An examination of the relevant Congressional debate reveals that the references to antitrust law and precedent were attempts to justify the extraordinary treble damage action as a device to deter organized crime; the notion that the objectives of RICO and the Sherman Act were identical was discounted.[19]

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[18] 1969 Hearings, Note 6, *supra*, at 556, 557.

[19] Senator Hruska noted that the legislation "seeks to strengthen the defense of legitimate business takeover by organized crime" and disavowed antitrust standing parallels. *See* 115 Cong. Rec. 6992 (1969). Senator McClellan echoed this point later, noting, "There is . . . no intention here of importing the great complexity of antitrust law enforcement into this field . . . ." *Id.* at 9567.

Moreover, to the extent that antitrust law and policy are increasingly concerned primarily with market efficiency rather than the deleterious effects of concentrated market power itself,[20] analogies to that body of law become increasingly irrelevant, since the exercise of social power by organized crime is thought to be *malum in se*.[21]

Finally, Congress' specific refusal to expand the Sherman Act to authorize RICO-type recoveries is not without significance. As the President of the American Bar Association noted in testifying on behalf of a separate RICO statute,

> [T]he use of the antitrust laws themselves as a vehicle for combating organized crime could create inappropriate and unnecessary obstacles in the way of persons injured by organized crime who might seek treble damage recovery. Such a private litigant would have to contend with a body of precedent—appropriate in a purely antitrust context—setting strict requirements on questions such as "standing to sue" and "proximate cause."[22]

In short, we believe, like most other courts, that the erection of a "competitive" or "indirect" injury barrier to RICO recovery comports with neither the plain language nor the central goal of the statute.

D. *Injury "By Reason Of" A* § 1962(c) Violation

Defendants' next argument is that, even if a RICO plaintiff need not allege a "competitive injury," he must plead injury "by reason of" a § 1962(c) violation, *i.e.*, by

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[20] *See, e.g., MCI Communications Corp. v. American Telephone and Telegraph Co.*, Nos. 80-2171 and 80-2288, slip op. at 37, 38 (7th Cir. Jan. 12, 1983).

[21] *See* Note, *Civil RICO: The Temptation and Impropriety of Judicial Restriction*, *supra*, at 1113, 1114.

[22] Organized Crime Control: Hearings on S. 30 Before the Subcommittee No. 5, House Committee on the Judiciary, 91st Cong., 20th Sess. at 149 (1969).

reason of the *operation* of an enterprise through the underlying pattern of racketeering activity, not by reason of the predicate offense itself. And the Director's complaint, they argue, alleges no such injury from the operation of ARC but rather only from the underlying mail fraud. Further, defendants maintain that § 1964(c) requires that plaintiffs must allege injury caused indirectly by a racketeering enterprise separate from the plaintiff itself. While we believe this latter argument to be without merit in view of our determination in III. C. *supra* that RICO was designed to protect *direct*, and not just second-order, victims of organized crime infiltration, we need not reach it here, for the Director's complaint, as construed in III A. *supra*, *does* allege an injury to Reserve by reason of the operation of a separate enterprise, ARC, through a pattern of racketeering activity. We also cannot accept the defendants' contention that the Director's complaint does not allege injury to Reserve by reason of the operation of ARC through the underlying fraud.

As noted in III A. *supra*, the whole thrust of the Director's complaint is that Reserve was a victim of the dishonest *operation* of *ARC* through a pattern of sham reinsurance, falsification of financial statements, and fraudulent dealings with state insurance regulators which allowed ARC to prolong Reserve's life beyond insolvency and thus exacerbate its financial woes. The Director does not allege that the predicate fraudulent acts were aimed directly at Reserve, as was the case with the plaintiffs in *Johnson v. Rogers*, No. CV 81-2464-CHH (C.D. Cal., Nov. 1, 1982); *Bays v. Hunter Savings Association*, 539 F. Supp. 1020, 1024 (S.D. Ohio 1982); *Harper v. New Japan Securities*, 545 F. Supp. 1002, 1007-08 (C.D. Cal. 1982); and *Erlbaum v. Erlbaum*, [Current] Fed. Sec. L. Rep. (CCH) ¶98,722 (E.D. Pa. 1982), cited by defendants.

Instead, the Director asserts that Reserve suffered from the defrauding of the State Department of Insurance which permitted ARC to cause Reserve to continue to operate beyond its insolvency and to allow Reserve to

be further drained of its income and more favorable business. Thus, the Director's allegation suggests an even stronger example of damage incurred through the operation of an enterprise than was alleged and upheld in *Computer Terminal Systems, Inc. v. Gross*, 1982 Trade Cases (CCH) ¶64,532 (E.D.N.Y. 1981), and *Hellenic Lines Ltd. v. O'Hearn*, 523 F. Supp. 244 (S.D.N.Y. 1981), approvingly cited by defendants, in which the plaintiff corporations were damaged by a scheme of bribes and kickbacks conducted *through* the plaintiff corporation, thus entailing financial losses which stemmed directly from the commission of the predicate offenses.

The defendant directors argue alternatively that the "by reason of" requirement is not met by the Director in the present allegations because he fails to allege that Reserve suffered damage which it would not have suffered had Reserve become insolvent for reasons having nothing to do with the underlying fraudulent operations proscribed by RICO. We must reject this argument on behalf of such attenuated "but for" causation; it is the logical equivalent of proposing that a murderer may not be held liable for his victim's death since the state cannot demonstate that the victim may not have perished eventually by accident. Equally fatuous is the suggestion of some of the defendants that they may not be held liable for damage arising from the fraudulent operation of ARC since Reserve's immediate injury stemmed from the Illinois Department of Insurance's assent to Reserve's continued operation. Such an argument plainly confuses cause with result, for the fraudulent operation of ARC was surely the alleged progenitor of Reserve's damage, regardless of whether the state regulatory authority was a necessary instrument in the accomplishment of that end.

In sum, we find that the complaint alleges a causal nexus between RICO-proscribed conduct and Reserve's damage sufficient to meet the requirements of § 1964(c).

E. *Miscellaneous Contentions*

The defendants cite several other defects in the theory of the Director's complaint. We find them also to be without merit, and discuss them briefly below.

Defendants first argue that our decision in *Cenco*, denying civil RICO standing to an accounting firm attempting to sue its client corporation for damages stemming from a fraud aided by the accounting firm, precludes the maintenance of the Director's standing in the instant case. In denying standing to the auditors in that case, we noted that it "is probably on behalf of the owners, perhaps also the customers and competitors, of such businesses that the [RICO] civil damages remedy was created, and not on behalf of the people who supply office equipment or financial or legal services to criminal enterprises that may be violating RICO." *Cenco*, 686 F. 2d at 455. We therefore concluded that Congress did not intend to create a cause of action for "all who may have suffered *indirectly* from the violation, especially where many of them would inevitably be, as here, the witting or unwitting tools of the violator." *Id.* at 457 (emphasis added). Defendants seize on this latter phrase and argue that, if an action may be denied to an auditor who is a "witting or unwitting tool" of the violator, *a fortiori* a "violator" (*i.e.*, Reserve) may not sue its "unwitting tool" (*i.e.*, the accountant defendants). Such an argument must fail, for, unlike in *Cenco*, we have found here that the complaint alleges that Reserve was a *victim* of the RICO violation, not its perpetrator. *See* II, *supra*, at 8-9. Therefore, the Director, as the statutory "owner" of Reserve and the *direct* victim of the defendants' unlawful activity, is precisely the kind of plaintiff who must be given standing in order to fulfill the deterrent objectives of RICO. *Cenco*, 686 F.2d at 455.

Defendants SCOR and SCOR Re next argue that they were not "employed by or associated with" ARC and are therefore excluded from liability under § 1962(c). They argue that § 1962(c) in essence requires that a defendant must be an "insider" or "manager" of the damage-causing enterprise in order to suffer liability. We do not

believe that the language and purpose of § 1962(c) supports such an interpretation.

As this court has noted before, in finding that a non-manager defendant arsonist met the § 1962(c) requirement, "The nature of racketeering connections to an otherwise legitimate business suggests that elements outside a company may assist in obtaining the company's illegal goals. Thus, '[t]he substantive proscriptions of the RICO statute apply to insiders *and outsiders*—those merely "associated with" an enterprise—who participate directly *and indirectly* in the enterprise's affairs through a pattern of racketeering activity. [Citations omitted]. Thus, the RICO net is woven tightly to trap even the smallest fish, those peripherally involved with the enterprise.'" *United States v. Starnes*, 644 F.2d 673, 679 (7th Cir. 1981), *quoting United States v. Elliott*, 571 F.2d 880, 903 (5th Cir. 1978), *cert. denied, sub nom. Delphi v. United States*, 439 U.S. 953 (1978) (emphasis in the original).[23] Other courts as well have had little trouble in finding that defendants who are not managers or employees in the colloquial sense are nevertheless reached by § 1962(c). *See Bennett v. Berg*, 685 F.2d 1053 (8th Cir. 1982), *pet. for reh. en banc granted, Sept. 17, 1982* (upholding liability against mortgage lender, attorneys, accountants of enterprise); *United States v. Bright*, 630 F.2d 804, 830-31 (5th Cir. 1980) (bonding company paying kickbacks to sheriff's office in return for business is sufficiently "associated with" that office); *United States v. Forsyth*, 560 F.2d 1127, 1135-36 (3d Cir. 1977) (magistrate receiving bribes from local bonding agency is sufficiently "associated with" latter enterprise; alternatively, magistrates are constructive

[23] Defendants suggest that *Starnes* is distinguishable because it involved a violation alleged under § 1962(d) which makes it unlawful for a person to *conspire* to violate § 1962(c). However, in *Starnes* we explicitly determined that the same enterprise-person nexus requirements contained in § 1962(c) were independently satisfied vis-a-vis the accused arsonist. *See Starnes*, 644 F.2d at 679.

"employees" of the enterprise); *Hanna v. Norcen Energy Resources, Ltd.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 98,742 (N.D. Ohio 1982) (upholding RICO liability against accounting firm and company in connection with client enterprise's securities fraud). The defendant insurance companies here, who allegedly entered into long-term contracts with ARC entailing complicated reinsurance and financing arrangements and SCOR's service as a conduit for Reserve's income and retroceded business, and the defendant auditors, who allegedly aided the managerial defendants in operating ARC through systematic fraud, are sufficiently "associated with" or "employed by" ARC within the meaning of the statute.

Defendants SCOR and SCOR Re argue next that their alleged conduct does not entail culpability under the predicate mail fraud allegation. They first argue that no deception took place because the State Director of Insurance was aware of, and agreed to, the SCOR reinsurance agreement. SCOR neglects to mention, however, that a key to the allegedly deceptive scheme, the clandestine retrocession agreement and guarantee by ARC of GRC's obligations to SCOR, were *not* disclosed to the state authorities, with the contemplated result that Reserve's *de facto* retention of liability for formally ceded business[24] secretly continued and deepened its insolvency. SCOR also argues that the fact that it entered into the reinsurance agreement several months *before* the consent decree negates any inference of SCOR's intent to defraud. The complaint, however, alleges that

[24] It is true, as defendants note, that the allegation does not spell out in detail the precise monetary liability which Reserve effectively maintained as a result of the secret agreements, but it does assert that there was "substantial risk of loss" from the ceded business retained by the entire "ARC insurance group," which includes Reserve. We consider such an allegation, at least at this stage, adequate to suggest that SCOR could have been aware of the misleading impact of the secret guarantee.

the negotiations in connection with the consent decree may have been underway in late 1974 at the time the SCOR agreement was concluded, with the full fraudulent impact in view and that SCOR was aware throughout subsequent years that the continued viability of the consent decree rested on the continued transmission of the fraudulent information; if proven, such facts clearly support an invocation of the mail fraud predicate offense under § 1961.

Finally, defendant Andersen suggests that the presence of the terms "he" and "his" in certain sections of RICO indicates that only biological individuals may violate RICO § 1962(c). We must reject this contention, as § 1961(3) plainly states that a violating "person" may be "any individual or entity capable of holding a legal or beneficial interest in property."

Conclusion

There is no doubt that many theoretical and practical objections may be raised to even the most routine application of RICO's civil damage provisions. As suggested above, Congress, by granting both plaintiff and defendant status to "any person" who possesses the rudimentary connection with the operation of an enterprise through predicate offenses or who suffers injury therefrom, may well have created a runaway treble damage bonanza for the already excessively litigious. The statute, however, does not speak ambiguously, and Congress, as RICO's legislative history indicates, was alerted to the far-reaching implications of its enactment. The legislature having spoken, it is not our role to reassess the costs and benefits associated with the creation of a dramatically expansive, and perhaps insufficiently discriminate, tool for combating organized crime. *United States v. Turkette*, 452 U.S. at 586-87 (1981).

With this principle in view, we find that the Director's complaint adequately states at least one cognizable claim under RICO, § 1962(c). We thus affirm the district court's denial of defendants' motion to dismiss

Counts I, II, III and IV of the complaint. We intend to express no judgment on the merits of the complaint.

AFFIRMED.

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APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT.
Chicago, Illinois 60604

July 1, 1983

Before
HON. WALTER J. CUMMINGS, Chief Judge
HON. HARLINGTON WOOD, JR., Circuit Judge
HON. WALTER HOFFMAN, Senior District Judge*

JAMES W. SCHACT, the Acting Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company,
Plaintiff-Appellee,
vs.
Nos. 82-2088, 82-2089, 82-2090
ISADORE BROWN, *et al.*,
Defendants-Appellants.

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 81 C 1475
Thomas R. McMillen, *Judge.*

ORDER

On consideration of the petitions for rehearing and suggestion for rehearing *en banc* filed in the above-entitled cause by the defendants-appellants, a vote of the active members of the Court was requested, and a majority** of the active members of the Court have voted to deny a rehearing *en banc*. All of the judges on the original panel have voted to deny the petitions for rehearing. Accordingly,

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* The Honorable Walter Hoffman, Senior District Judge of the Eastern District of Virginia, is sitting by designation.

** Judges Eschbach and Posner voted to grant a rehearing *en banc*. Judge Cudahy disqualified himself and took no part in the consideration or decision of the petitions.

IT IS ORDERED that the aforesaid petitions for rehearing be, and the same are hereby, DENIED.

In addition, the opinion in the above-entitled cause is hereby amended as follows:

The last paragraph commencing on page 10 and continuing to page 11 should read, after the present first two sentences, as follows:

> We were also troubled in *Cenco* by the prospect of double recovery by the shareholders via the plaintiff corporation in view of the *previous* successful recovery of damages by these same shareholders in a direct suit against the defendants. In this case, by contrast, the other actions noted to this court based on these alleged events have yet to result in any recovery. Of course, if the Director recovers successfully in the instant suit, the defendants in these actions will be able to assert the previous satisfaction of the claims of the shareholders, policyholders, and creditors of Reserve as a bar to subsequent recovery.

In addition, footnote 5 should be stricken, and the remaining footnotes renumbered accordingly.

APPENDIX C

United States District Court

Northern District of Illinois
Eastern Division

PHILIP R. O'CONNOR, *Plaintiff,*
v.
ISADORE BROWN, et al., *Defendants.*

No. 81 C 1475

DECISION ON PENDING MOTIONS

Most of the defendants have filed motions to dismiss the complaint in this case for lack of subject matter jurisdiction. A few ancillary motions are also long-pending due to the fact that this case has recently been transferred to the undersigned from former Judge Crowley through various procedures. The basis for federal jurisdiction is alleged in Counts II and IV under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 (1970), so we will deal with the allegations of those two counts first.

We conclude that plaintiff has stated a claim for damages under R.I.C.O. against all of the named defendants by exercising the rights granted under §§ 1962(a) and (c) and 1964(C) of the Act. As the parties are well aware, this statute has been applied by judicial decision to legitimate and illegal enterprises alike. *United States* v. *Turkette*, U.S. 101 S.Ct. 2524 (1981). Similarly, the statute has been made applicable to any "persons," whether or not they are engaged in organized crime. *United States* v. *Aleman*, 609 F.2d 298 (7th Cir. 1979), *cert. denied*, 445 U.S. 946 (1980). The essential elements required to plead a claim for damages under R.I.C.O., therefore, are a "pattern" of violation of those federal criminal statutes listed in § 1961(1) and engagement

in activities which affect interstate commerce. The dictionary definition of such words as "racketeering" and "enterprise," among others, are superseded by the statutory and judicial interpretations of these particular words.

Contrary to the contention of certain defendants, we find and conclude that the liquidator of Reserve Insurance Company, plaintiff, has standing to sue on behalf of the stockholders, policyholders, and creditors of that company and is not bound by the allegedly fraudulent or other ultra-vires acts of the officers and directors of the corporation. Although no Illinois or federal cases in this jurisdiction so hold insofar as we have been advised by the briefs, it would be an absurd result to rule that the Director of Insurance as liquidator of Reserve Insurance Company could not recover damages on behalf of the foregoing interested persons based on the improper and fraudulent acts of the officers and directors of the company being liquidated. If a court decision is required to support this self-evident conclusion, plaintiff has supplied us with the case of *Bonhiver* v. *Graft,* [sic] 248 N.W.2d 291 (S.Ct. Minn. 1976). The same case supports a cause of action against outsiders, such as the three accounting firms which are defendants in this case.

The existence of an alleged "pattern" is satisfied by the factual allegations of paragraphs 25 through 61 which cover a series of financial transactions beginning in 1974 and continuing through at least 1977. Since three separate and temporally isolated burglaries were sufficient to satisfy the "pattern" requirement of R.I.C.O. in the *Aleman* criminal case (*supra* p. 2), certainly the various transactions which are specified in the foregoing paragraphs of the complaint constitute a pattern in the case at bar. Whether each separate defendant participated in this pattern or even participated in the "enterprise" subjecting him or it to R.I.C.O. is a matter which cannot be decided on a motion to dismiss the complaint, particularly since Counts II and IV allege a "conspiracy" among all of the defendants.

The substantive jurisdictional question is whether or not the Federal Mail Fraud statute was violated by the defendants, since only certain federal criminal laws are embraced by R.I.C.O. The provisions of 18 U.S.C. § 1341 are invoked by plaintiff in Counts II and IV. The mailings specified in paragraphs 76 and 93 of the complaint extend from March 25, 1975 to March 10, 1978. We note that most of the individual defendants are alleged to have been directors of Reserve only "part of the time" between January 1, 1974 and March 12, 1979, and the three accountant defendants participated during different periods of time. Although some of the defendants may not have participated in the alleged conspiracy or pattern for the entire period embraced by the complaint, their alleged presence at one relevant time or the other suffices to state a claim.

We will add that a motion to dismiss in the federal courts can be granted, generally, only if the plaintiff has not set out sufficient allegations, assumed by the motion to be true, to show that he might be able to recover on a federal cause of action against the defendants after full discovery; when a conspiracy among the defendants is properly alleged, the allegations reach to all of them. In order for any individual defendant to extricate himself or itself from such a complaint, he must allow the plaintiff to proceed with discovery and then try to find his defense by a motion for summary judgment or at trial. This concededly is not a simple task, as is filing a motion to dismiss for failure to state a claim, but on the other hand the burden of the plaintiff is considerably enhanced after he has succeeded on the threshold motions. The lack of specificity in the complaint is not fatal on a motion to dismiss, since the motion admits well-pleaded facts and inferences therefrom.

The other contentions of defendants with respect to the R.I.C.O. counts are of no persuasive weight. A member of a conspiracy to commit mail fraud need not personally use the mails, so long as their acts result in that violation. *Pereira* v. *United States*, 347 U.S. 1 (1954); *United States* v. *Keane*, 522 F.2d

534 (7th Cir. 1975), *cert. denied*, 424 U.S. 976 (1976). Nor does R.I.C.O. require "competitive injury" between the defendants, or between the plaintiff and defendants. It merely requires activities in interstate or foreign commerce and injury to the business or property of the plaintiff. See Turkette, U.S. , 101 S.Ct. 2527, 2528-29 *supra*, p. 2; 18 U.S.C. § 1964(c).

As to the form of the pleadings, we find the allegations of mail fraud to be sufficiently specific under F.R.C.P. 9(b), and we also find the allegations of a conspiracy which are incorporated into these two counts sufficient to place all of the defendants on notice concerning the nature of the claims against them and their alleged participation in the pattern of racketeering activity. Officers and directors of a corporation have a fiduciary obligation toward the persons represented by the plaintiff, and, since the specific activities of the defunct insurance companies of which they were fiduciaries are alleged in detail, this satisfies Rule 9 in our opinion. The activities of the accounting defendants are more specifically alleged and do not depend upon a fiduciary relationship. *See*, for example, *I.I.T. etc.* v. *Cornfeld*, 619 F.2d 909, 924 (2d Cir. 1980).

The threshold motions in this case are complicated by a federal statute which is not only pervasive and somewhat ambiguous but which also has not been subjected to thorough judicial scrutiny or Congressional amendments. We are satisfied, however, that plaintiff has stated a claim under R.I.C.O. against the defendants, and that their motions to dismiss Counts II and IV must be denied.

All of the remaining 18 counts of the complaint are based on pendent State causes of actions. Counts X through XX are solely against the accountant defendants based upon breach of contract, negligence, and fraud. They do not seek relief against the insurance companies or their officers or directors or allege a conspiracy with them. To the extent that the allegations of fraud involve the use of United States mails, they are subsumed by Counts II and IV. To the extent

that a federal criminal statute is not involved, these counts allege purely State claims and are not pendent to the federal counts. They will therefore be dismissed without prejudice pursuant to *United Mine Workers* v. *Gibbs,* 383 U.S. 715 (1966) and *Smith* v. *No. 2 Galesburg Crown Finance Corp.,* 615 F.2d 407 (7th Cir. 1980); *see also Nickerson* v. *Thomas,* 504 F.2d 813, 817 (7th Cir. 1974). Because of this dismissal, we will not act upon the motions filed by the accountant defendants with respect to certain matters involved in Counts XIX and XX.

Counts V through IX are allegations that the "officers and directors" of Reserve and the other corporate defendants violated various provisions of the Illinois statutes governing the operation of insurance companies and committed other acts of misfeasance or malfeasance. None of these counts allege any violation of the federal mail fraud statutes. The specific "breaches of fiduciary duties" and "frauds" alleged in these counts may or may not be subsumed in the two R.I.C.O. counts, but if they are, they need not be realleged in separate counts. In substance, these counts seem to be merely an attempt to shift to the federal court the supervision of insurance companies by the Illinois Director of Insurance. Except to the extent that a pattern of racketeering activity affecting interstate or foreign commerce might be involved, we are quite sure that Congress by enacting R.I.C.O. did not intend for the federal courts to undertake the responsibility of the Illinois courts and the Illinois Director of Insurance to liquidate and marshal the assets of insolvent insurance companies in this State. These counts have not been alleged with sufficient relevance to the R.I.C.O. counts to permit them to remain here as pendent claims.

Counts I and III allege a civil conspiracy which is closely related to the alleged mail fraud violations of Counts II and IV and are incorporated by reference into Counts II and IV. As we read the allegations, the evidence and proof for Counts I and III would be closely related, if not essential, to Counts II and IV. Therefore, even though Counts I and III allege

non-federal claims, they should remain pendant, at least at this stage of the case.

Motion to Dismiss for Insufficient Service of Process

Defendants Guaranty Reinsurance Company and Reserve Insurance Managers, Ltd., both of which are domiciled in Bermuda, have filed a motion to dismiss for failure to be properly served. This motion has not been briefed in accordance with Local Rule 13 and therefore should be denied for lack of support. On its merits, also, it appears that these insurance companies have been properly served at their last known principal address, as is required by ch. 73, § 735 (B) of the *Ill. Rev. Stat.* The motions are therefore denied.

Motion to Compel

Plaintiff has filed a motion to compel the acountant defendants to produce documents pursuant to F.R.C.P. 34. These defendants initially objected to the notices to produce because of their pending motions to dismiss. Since the motions have been denied as to Counts I through IV, this ground for the failure to produce is no longer viable.

Defendants also have claimed an accountants' privilege pursuant to Illinois law. They do not raise this objection with respect to R.I.C.O., however, and no such privilege exists. However, because of the confidential nature of many of the documents requested, defendants are entitled to a protective order which will restrict the use and publication of the documents pending trial.

The other objections relate to relevancy. We cannot decide this issue for several reasons, the first of which is that no Rule 12D conference apparently has been held in order to attempt to resolve this particular issue. Secondly, no production will be required for documents which are irrelevant to Counts I through IV, since the remaining counts have been dismissed. Thirdly, most of the defendants' concern on the question of relevancy can be overcome by a proper protective

order followed by a tender of documents which are presently subject to the non-destruct order entered July 1, 1981 by Judge Marshall and therefore can be tendered to plaintiff *en masse* pursuant to F.R.C.P. 33(c). It appears that many of the documents in question have been produced to a Federal agency, so we assume that the burden of production is not substantial, if a proper protective order is agreed to.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the motions of defendants to dismiss Counts I, II, III and IV are denied and defendants are ordered to file answers thereto within twenty (20) days hereof. The motion of Guaranty Reinsurance Company and Reserve Insurance Managers, Ltd., to quash service of process is denied.

The motion to dismiss Counts V through XX is granted and they are dismissed, without prejudice.

Plaintiff's motion to compel is entered and continued, subject to the procedures outlined hereinabove.

The stay order with respect to discovery entered by Judge Crowley on May 18, 1981 is vacated.

A preliminary pretrial conference will be held in this case in chambers on Thursday, February 25, 1982 at 9:15 a.m. by which time the parties are ordered to have complied with F.R.C.P. 26(f) and to file a proposed schedule of discovery.

ENTER:

/s/ THOMAS R. MCMILLEN

Judge, U.S. District Court

DATED: Jan. 21, 1982

APPENDIX D

IN THE

United States District Court

Northern District of Illinois
Eastern Division

PHILIP R. O'CONNOR,	*Plaintiff,*	No. 81 C 1475
v.		
ISADORE BROWN, et al.,	*Defendants.*	

ORDER

Most of the defendants in the above-entitled cause have filed motions for certification under the Interlocutory Appeals Act, or alternatively, for reconsideration or our decision of January 21, 1982 denying defendants' motions to dismiss the complaint for lack of subject matter jurisdiction. In that decision we found that Counts II and IV of the complaint stated a claim for damages under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 (1970).

We deny defendants' motions insofar as they seek reconsideration, and certify to the United States Court of Appeals for the Seventh Circuit, our January 21, 1982 decision insofar as it held that plaintiff stated a claim for damages under R.I.C.O., 18 U.S.C. § 1964(c). While we are of the opinion that the complaint comes within the literal terms of the civil treble damage provision of R.I.C.O., we agree with defendants that this involves a controlling question of law as to which there is substantial ground for difference of opinion. cf. *Cenco, Inc.* v. *Seidman & Seidman*, F.2d , (7th Cir. Nos. 81-2126, 81-2264, Mar. 26, 1982); *United States* v. *Bledsoe, et al.*, F.2d , (8th Cir. Nos. 80-1998 *et seq.* and 80-2114, Mar. 12, 1982).

Since the two R.I.C.O. counts provide the sole basis for federal jurisdiction in this case, we further find that an immediate appeal from the decision may materially advance the ultimate termination of the litigation.

Defendants have submitted several specific questions for certification, none of which adequately reach all issues material to our order denying the motions to dismiss. Section 1292(b) does not require that we certify a specific legal question; rather, the statute merely contemplates appeals from certain kinds of orders. *Nuclear Engineering Co.* v. *Scott*, 660 F.2d 241, 246 (7th Cir. 1981); *Civil Aeronautics Board* v. *Tour Travel Enterprises*, 605 F.2d 998, 1003 n.12 (7th Cir. 1979). We therefore will not certify a particular question.

Nevertheless, we view the controlling question as whether Congress, by enacting R.I.C.O., intended to create a civil claim for damages for any person injured in his business or property by reason of a violation of § 1962 by defendants who allegedly participated in various ways in two of more acts of common law fraud involving use of the United States mails within a ten year period. This question goes to our jurisdiction, and a decision adverse to plaintiff will remove any basis for federal jurisdiction over this controversy.

We hereby certify our decision of January 21, 1982 for interlocutory appeal. Application for appeal from this order shall not stay proceedings in this court.

ENTER:

/s/ THOMAS R. MCMILLEN
Judge, U.S. District Court

DATED: Apr. 30, 1982

APPENDIX E

Opinion by Judge Wood
JUDGMENT—ORAL ARGUMENT

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

April 8, 1983

Before
HON. WALTER J. CUMMINGS, Chief Judge
HON. HARLINGTON WOOD, JR., Circuit Judge
HON. WALTER HOFFMAN, Senior District Judge*

JAMES W. SCHACT, the Acting Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company,
Plaintiff-Appellee,
vs.
Nos. 82-2088, 82-2089, 82-2090
ISADORE BROWN, *et al.,*
Defendants-Appellants.

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 81 C 1475
Thomas R. McMillen, *Judge.*

This cause was heard on the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this Court filed this date.

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* The Honorable Walter Hoffman, Senior District Judge of the Eastern District of Virginia, is sitting by designation.

In The

United States District Court

For the Northern District of Illinois

PHILIP R. O'CONNOR, Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company,
Plaintiff,

v.

ISADORE BROWN, ROGER O. BROWN, JULES DASHOW, WALTER Y. ELISHA, NORMAN M. GOLD, BURTON I. KOFFMAN, WALLACE J. STENHOUSE, JR., HUGO UYTERHOEVEN, ANTHONY M. TORTORIELLO, DONALD J. CLARKIN, JERROLD N. FINE, JOHN W. MULDOON, STANTON I. SUBECK, MICHAEL L. MEYER, JOHN J. TICKNER, ARTHUR ANDERSEN & CO., COOPERS & LYBRAND, ALEXANDER GRANT & COMPANY, SOCIETE COMMERCIALE DE REASSURANCE COMPANY, SCOR REINSURANCE COMPANY, GUARANTY REINSURANCE COMPANY and RESERVE INSURANCE MANAGERS, LTD.,
Defendants.

No. 81 C 1475

COMPLAINT

INDEX

	PAGE
JURISDICTION AND VENUE	2
THE PARTIES	2
FACTUAL BACKGROUND	8
COUNT I	
Civil Conspiracy Claim Against Officers and Directors, SCOR, SCOR Reinsurance, GRC and Managers	24
COUNT II	
RICO Claim Against Officers And Directors, SCOR, SCOR Reinsurance, GRC and Managers	29
COUNT III	
Civil Conspiracy Claim Against Officers And Directors And Andersen, Coopers and Grant	32
COUNT IV	
RICO Claim Against Officers And Directors And Andersen, Coopers and Grant	35
COUNT V	
Breach of Fiduciary Duty Claim Against Officers and Directors	38
COUNT VI	
Willful, Wanton And Intentional Breach Of Fiduciary Duty Claim Against Officers And Directors—Punitive Damages	41
COUNT VII	
Negligent Mismanagement Claim Against Officers And Directors	41
COUNT VIII	
Willful, Wanton And Intentional Mismanagement Claim Against Officers And Directors—Punitive Damages	44
COUNT IX	
Fraud Claim Against Officers And Directors—Compensatory and Punitive Damages	44
COUNT X	
Breach of Contract Claim Against Andersen (1974)	47

COUNT XI
Breach of Contract Claim Against Andersen (Reserve 1974) 48
COUNT XII
Breach of Contract Claim Against Andersen (1975) 50
COUNT XIII
Breach of Contract Claim Against Coopers 51
COUNT XIV
Breach of Contract Claim Against Grant (Reserve 1976) 53
COUNT XV
Breach of Contract Claim Against Grant (1977) .. 54
COUNT XVI
Breach of Contract Claim Against Grant (Reserve 1977) 56
COUNT XVII
Negligence Claim Against Andersen, Coopers and Grant 57
COUNT XVIII
Fraudulent Misrepresentation Claim Against Andersen, Coopers And Grant—Compensatory And Punitive Damages 60
COUNT XIX
Breach of Fiduciary Duty Claim Against Andersen, Coopers And Grant 63
COUNT XX
Willful, Wanton And Intentional Breach Of Fiduciary Duty Claim Against Andersen, Coopers and Grant—Punitive Damages 66

In The

United States District Court

For the Northern District of Illinois

PHILIP R. O'CONNOR, Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company,
Plaintiff,

v.

ISADORE BROWN, ROGER O. BROWN, JULES DASHOW, WALTER Y. ELISHA, NORMAN M. GOLD, BURTON I. KOFFMAN, WALLACE J. STENHOUSE, JR., HUGO UYTERHOEVEN, ANTHONY M. TORTORIELLO, DONALD J. CLARKIN, JERROLD N. FINE, JOHN W. MULDOON, STANTON I. SUBECK, MICHAEL L. MEYER, JOHN J. TICKNER, ARTHUR ANDERSEN & CO., COOPERS & LYBRAND, ALEXANDER GRANT & COMPANY, SOCIETE COMMERCIALE DE REASSURANCE, SCOR REINSURANCE COMPANY, GUARANTY REINSURANCE COMPANY and RESERVE INSURANCE MANAGERS, LTD.,
Defendants.

No. 81 C 1475

COMPLAINT

Plaintiff PHILIP R. O'CONNOR, Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company, by his attorneys Burke and Smith Chartered, complains against defendants ISADORE BROWN, ROGER O. BROWN, JULES DASHOW, WALTER Y. ELISHA, NORMAN M. GOLD, BURTON I. KOFFMAN, WALLACE J. STENHOUSE, JR., HUGO UYTERHOEVEN, ANTHONY M. TORTORIELLO, DONALD J. CLARKIN, JERROLD N. FINE, JOHN W. MULDOON, STANTON I. SUBECK, MICHAEL L. MEYER, JOHN J. TICKNER, ARTHUR ANDERSEN & CO., COOPERS & LYBRAND,

ALEXANDER GRANT & COMPANY, SOCIETE COMMERCIALE DE REASSURANCE, SCOR REINSURANCE COMPANY, GUARANTY REINSURANCE COMPANY and RESERVE INSURANCE MANAGERS, LTD. as follows:

JURISDICTION AND VENUE

1. This court has jurisdiction over the claims herein pursuant to the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§ 1961 *et seq.*, and particularly 18 U.S.C. § 1964(c); and the principles of pendent jurisdiction.

2. All the defendants are citizens or residents of or are domiciled, or authorized to do business in the State of Illinois, or have submitted to the jurisdiction of this court pursuant to ch. 110, § 17, Ill. Rev. Stat.; and most of the acts complained of herein occurred in the Northern District of Illinois.

3. Venue properly rests in the Northern District of Illinois pursuant to 28 U.S.C. § 1391.

THE PARTIES

4. Plaintiff Philip R. O'Connor is the Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company ("Reserve"). Reserve is a stock insurance company organized under the laws of the State of Illinois. By order of the Circuit Court of Cook County, County Department, Chancery Division, the Honorable Judge O'Brien presiding, on May 29, 1979, in the cause entitled *People ex rel. Richard L. Mathias* v. *Reserve Insurance Company*, No. 79 CH 2828, Reserve was adjudged insolvent pursuant to the Illinois Insurance Code ch. 73, §§ 813, *et seq.*, Ill. Rev. Stat. The plaintiff has title to this right of action pursuant to ch. 73, § 803, Ill. Rev. Stat. Any recovery obtained herein becomes an asset of the liquidation estate of Reserve and will be distributed pursuant to ch. 73, § 817, Ill. Rev. Stat., to Reserve's policyholders, creditors and shareholders.

5. Defendant Isadore Brown ("I. Brown") is a citizen and resident of the State of Illinois. I. Brown was at all times from at least January 1, 1974, through December 31, 1976, a member of the board of directors of American Reserve Corporation ("ARC"), the parent corporation of Reserve. During at least part of that time, I. Brown was also a director of Reserve.

6. Defendant Roger O. Brown ("R. O. Brown") is a citizen and resident of the State of Illinois. From at least January 1, 1974, through December 31, 1976, R. O. Brown was at all times a member of the board of directors of ARC. During at least part of that time, R. O. Brown was also a member of the audit committee of the board of directors of ARC.

7. Defendant Jules Dashow ("Dashow") is a citizen and resident of the State of Illinois. Dashow was at all times from at least January 1, 1974, through March 12, 1979, a member of the board of directors of ARC. During at least part of that time, Dashow was also a director of Reserve.

8. Defendant Walter Y. Elisha ("Elisha") is a citizen and resident of the State of South Carolina. Elisha was at all times from at least January 1, 1974, through December 31, 1975, a member of the board of directors of ARC. During at least part of that time, Elisha was also a director of Reserve.

9. Defendant Norman M. Gold ("Gold") is a citizen and resident of the State of Illinois. Gold was at all times from at least January 1, 1974, through March 12, 1979, a member of the board of directors of ARC. During at least part of that time, Gold was also a director of Reserve. Gold was also, at least during part of this time, a member of the audit committee and the corporate organization and compensation committee of the board of directors of ARC.

10. Defendant Burton I. Koffman ("Koffman") is a citizen and resident of the State of New York. Koffman was at all times from at least January 1, 1974, through December 31, 1978, a member of the board of directors of ARC. During

at least part of that time, Koffman was also a director of Reserve.

11. Defendant Wallace J. Stenhouse, Jr. ("Stenhouse") is a citizen and resident of the State of Illinois. Stenhouse was at all times from at least January 1, 1974, through March 12, 1979, the chairman of the board of directors and the chief executive of ARC and Reserve. Until approximately January 1, 1977, Stenhouse was also the president of ARC and Reserve. Moreover, during at least part of this time, Stenhouse was a member of the corporate organization and compensation committee of the board of directors of ARC.

12. Defendant Hugo Uyterhoeven ("Uyterhoeven") is a citizen and resident of the Commonwealth of Massachusetts. Uyterhoeven was at all times from at least January 1, 1974, through March 12, 1979, a member of the board of directors of ARC. During at least part of this time, Uyterhoeven was also a director of Reserve. Moreover, during at least part of this time, Uyterhoeven was a member of the corporate organization and compensation committee of the board of directors of ARC.

13. Defendant Anthony M. Tortoriello ("Tortoriello") is a citizen and resident of the State of Illinois. Tortoriello was at all times from approximately April, 1976, through March 12, 1979, a member of the board of directors of ARC. During at least part of this time, Tortoriello was also a director of Reserve. Moreover, during at least part of this time, Tortoriello was also a member of the audit committee and the corporate organization and compensation committee of the board of directors of ARC.

14. Defendant Donald J. Clarkin ("Clarkin") is a citizen and resident of the Commonwealth of Pennsylvania. Clarkin was at all times from at least January 1, 1974, through December 31, 1976, a vice president and treasurer of ARC, and from at least January 1, 1977, through June of 1977, a member of the board of directors of ARC. Moreover,

during at least part of this time, Clarkin was executive vice president and treasurer of Reserve.

15. Defendant Jerrold N. Fine ("Fine") is a citizen and resident of the State of Connecticut. Fine was at all times from at least January 1, 1977, through March 12, 1979, a member of the board of directors of ARC.

16. Defendant John W. Muldoon ("Muldoon") is a citizen and resident of the State of Illinois. Muldoon was from at least January 1, 1974, through December 31, 1976, a vice president of ARC. During at least part of this time, Muldoon was also executive vice president of Reserve. From approximately January 1, 1977, through at least March 12, 1979, Muldoon was the president and chief operating officer and a member of the board of directors, of ARC. During at least part of this time, he was also the president and a director of Reserve.

17. Defendant Stanton I. Subeck ("Subeck") is a citizen and resident of the State of Illinois. Subeck was at all times from March, 1978, through March 12, 1979, vice president, treasurer and chief financial officer of ARC and a member of the board of directors of ARC. During at least part of this time, Subeck was also a vice president, executive vice president and chief financial officer, and a director of Reserve.

18. Defendant Michael L. Meyer ("Meyer") is a citizen and resident of the State of Illinois. Meyer was at all times since at least January 1, 1974, through March 12, 1979, the secretary of ARC. During most, if not all, of this time, Meyer was also the secretary of Reserve.

19. Defendant John J. Tickner ("Tickner") is a citizen and resident of the State of Illinois. Tickner was at all times from at least November 1, 1975, through at least February 24, 1978, a senior vice president and general counsel of Reserve.

20. The defendants identified in paragraph 5 through 19, inclusive, will be referred to collectively herein as "officer and director defendants" or "officers and directors".

21. Defendant Arthur Andersen & Co. ("Andersen") is a partnership of certified public accountants engaged in the practice of public accounting in many states, including the State of Illinois, and maintains its principal place of business in Chicago, Illinois. Andersen was retained by Reserve, or in the alternative was retained by ARC for the benefit of Reserve, to audit Reserve and prepare ARC's consolidated financial statements for the years ending December 31, 1969, through 1975, and was retained by Reserve to audit its separate financial statements for at least the years ending December 31, 1969, 1970, 1971 and 1974. Andersen did in fact audit those financial statements and did in fact issue an unqualified letter of opinion with respect to each of those financial statements.

22. Defendant Coopers & Lybrand ("Coopers") is a partnership of certified public accountants, engaged in the practice of public accounting in many states, including the State of Illinois. Coopers was retained by Reserve, or in the alternative was retained by ARC for the benefit of Reserve, to audit Reserve and prepare ARC's consolidated financial statement for the year ending December 31, 1976. Coopers did in fact issue an unqualified letter of opinion with respect to that financial statement.

23. Defendant Alexander Grant & Company ("Grant") is a partnership of certified public accountants engaged in the practice of public accounting in many states, including the State of Illinois. Grant was retained by Reserve, or in the alternative was retained by ARC for the benefit of Reserve, to audit Reserve and prepare ARC's consolidated financial statement for the year ending December 31, 1977. Grant did in fact audit that consolidated financial statement and did in fact issue an unqualified letter of opinion with respect to that financial statement. Grant was also retained by Reserve to audit the separate financial statements for Reserve for the

years ending December 31, 1976, and December 31, 1977. Grant did in fact audit those financial statements and did in fact issue an unqualified letter of opinion with respect to the December 31, 1976, financial statement and an unqualified letter of opinion, except for a timing question on a capital contribution and an allocation problem as to affiliates that had a minimal effect on the statements, with respect to the December 31, 1977, financial statement.

24. Defendant Societe Commerciale De Reassurance ("SCOR") is an alien corporation organized under the laws of and domiciled in France. SCOR was at all relevant times engaged in the business of insurance and reinsurance.

24.1. Defendant SCOR Reinsurance Company ("SCOR Reinsurance") is a foreign corporation organized under the laws of and domiciled in Texas, and is authorized to do business in Illinois.

24.2. Defendant Guaranty Reinsurance Company ("GRC") is an alien corporation organized under the laws of and domiciled in Bermuda. GRC was at all relevant times engaged in the business of insurance and reinsurance.

24.3. Defendant Reserve Insurance Managers, Ltd. ("Managers") is an alien corporation organized under the laws of and domiciled in Bermuda.

FACTUAL BACKGROUND

25. Prior to January 1, 1974, ARC was an insurance holding company. Its principal operating subsidiary was Reserve, all of whose outstanding shares of stock were owned by ARC. Reserve, in turn, owned all of the outstanding shares of Market Insurance Company ("Market") which wrote insurance business principally in Illinois. ARC had numerous other sudsidiaries, including GRC and Managers, each of whose outstanding shares of stock were wholly owned by ARC. The relevant part of ARC's corporate structure at this time is illustrated on the chart attached hereto as Exhibit "A".

26. Beginning in the late 1960's and continuing through 1974, ARC and its two principal operating subsidiaries, Reserve and Market, continually underreserved for claims and claims administration expenses. Andersen was aware of this fact and urged ARC to increase their reserves. However, Andersen failed to qualify its opinion letters on ARC's consolidated financial statements, which purported to show the financial condition of ARC, Reserve and Market, even though ARC failed to create all the reserves which Andersen knew were necessary.

27. In 1974, ARC, Reserve and Market suffered substantial operating losses with respect to insurance written in previous years, much of which was extremely high-risk excess and surplus liability coverage, such as medical malpractice, high limit products liability, and the coverage of such exotic risks as shrimp boats and gypsy carnivals. As a result of these substantial operating losses, the policyholders' surplus ("surplus") of Reserve was substantially diminished and Reserve became a highly leveraged company (i.e., having a ratio of premiums written to surplus of substantially more than 4 to 1).

28. In spite of these substantial losses, ARC, Reserve and Market failed to provide reserves for claims and claims administration expenses adequate to cover their liabilities with respect to prior years' insurance policies. Nor did these companies provide adequate reserves with respect to new policies that were being written.

29. Andersen was aware of the deficiencies in these reserves, but it nonetheless rendered an unqualified opinion as to ARC's December 31, 1974, consolidated financial statement, which statement purported to reflect the financial condition of ARC, Reserve and Market. Andersen also rendered an unqualified opinion as to the separate financial statement of Reserve for the year ending December 31, 1974. In reality, Reserve was insolvent at least as of December 31, 1974, and remained insolvent at all relevant times herein.

30. ARC, Reserve and Market entered into an agreement in December, 1974, with SCOR, whereby Reserve and Market ceded a substantial part of their insurance business to SCOR. Under the terms of the agreement, Reserve and Market ceded to SCOR a 90% share of those lines of their business which had the greatest profit and consistently lowest loss ratios, and SCOR paid to Reserve and Market a 45% provisional commission on this business. SCOR Reinsurance served as the broker for the cession from Reserve and Market to SCOR. Pursuant to an additional agreement between SCOR and ARC, SCOR retroceded to GRC 90% of the business ceded to SCOR by Reserve and Market. Because the capitalization of GRC was insufficient to cover the potential losses involved in this retrocession, ARC agreed to guarantee GRC's obligations to SCOR. Managers served as the broker for the retrocession from SCOR to GRC.

31. Pursuant to ch. 73, §§ 785-787, Ill. Rev. Stat., Reserve and Market needed the approval of the Illinois Department to enter into the SCOR arrangement. Reserve and Market, largely through the efforts of Tickner and Stenhouse, obtained the approval of the Illinois Department in December, 1974. In so doing, they disclosed only the cession from Reserve and Market to SCOR, and not the retrocession from SCOR to GRC, or ARC's guarantee of GRC's obligations to SCOR, and they further failed to disclose that Reserve was insolvent at the time of the execution of the SCOR agreements.

32. The SCOR reinsurance arrangement, when approved by the Illinois Department, enabled Reserve and Market to report a smaller premium volume and thus a lower premium-to-surplus ratio. That ratio was further lowered by Reserve and Market reporting as commission income 45% of the unearned premiums on the business ceded to SCOR. The net effect of the SCOR agreements was to transfer 81% of Reserve's and Market's more profitable and less risky business to GRC, a non-regulated company, while leaving

Reserve and Market with a smaller premium volume consisting of the least profitable and most risky business. The SCOR agreements had the further effect of concealing Reserve's insolvency.

33. As long as ARC remained solvent, SCOR, under the original agreement with ARC, assumed no actual liability for the insurance ceded to it by Reserve and Market. The SCOR reinsurance arrangement was not true reinsurance, but a financing scheme.

34. The reinsurance agreements remained in effect from approximately December, 1974, through September, 1978. During that time span Reserve and Market "reinsured" in excess of $155,000,000 of premiums with SCOR. In turn, SCOR retroceded to GRC in excess of $122,000,000 of those premiums.

35. In addition to reimbursement of its expenses and the underwriting earnings which it received on the insurance business ceded to and retained by it, SCOR received additional payments in excess of $2.5 million from ARC.

36. The officers and directors of ARC and Reserve at the time the SCOR arrangement was entered into knew that it was entered into to conceal Reserve's insolvency. The subsequent officers and directors of ARC and Reserve knew and approved of the SCOR arrangement after its implementation.

37. Upon information and belief, SCOR Reinsurance served as a broker for, and SCOR entered into this arrangement in December, 1974, with the knowledge that its net effect was to transfer most of Reserve's and Market's more profitable and less risky business, while leaving Reserve and Market with the least profitable and more risky business. Upon information and belief, SCOR and SCOR Reinsurance knew that the reinsurance arrangement was entered into to conceal Reserve's insolvency. Upon information and belief, SCOR and SCOR Reinsurance knew in December, 1974, that Reserve was insolvent.

37.1. Managers served as a broker for, and GRC entered into this arrangement in December, 1974, with the knowledge that its net effect was to transfer most of Reserve's and Market's more profitable and less risky business, while leaving Reserve and Market with the least profitable and more risky business. GRC and Managers knew that the reinsurance arrangement was entered into to conceal Reserve's insolvency. GRC and Managers knew in December, 1974, that Reserve was insolvent.

38. Because of concern over the diminution of Reserve's surplus, the Illinois Department of Insurance ("the Illinois Department") began negotiations in late 1974 or early 1975 with the then officers and directors of ARC, Reserve and Market, which eventually resulted in the execution of a consent agreement on or about April 15, 1975, whereby Reserve agreed, *inter alia*, to: (1) reduce its ratio of premiums to surplus to 4 to 1 or less, (2) desist from any intercompany transactions such as loans or the sale of securities with its parent or affiliates without the prior approval of the Illinois Department, (3) neither loan nor pledge its assets without the prior approval of the Illinois Department, (4) submit all reinsurance agreements which cede or assume $2 million annual premium or more to the Illinois Department to [sic] its approval, (5) restrict the declaration of dividends to its parent company, and (6) increase its policyholder security deposit account to an amount equal to 100% of its reserves for claims and claims administration expenses plus 50% of its reserve for unearned premium. A copy of the consent agreement is attached hereto as Exhibit "B".

39. The reasons for, purpose of, and existence of this consent agreement and its material and potentially adverse effects on the ability of Reserve and Market to continue to write a high volume of business and to maintain an effective marketing structure were known by each of the defendants who was an officer and director of ARC or Reserve at the time the consent agreement was being negotiated, and later when it was signed. Andersen also knew of the negotiations

concerning, the purposes of, and the reasons which led to the execution of this consent agreement and its potentially adverse effects on ARC, Reserve and Market, but these were not fully disclosed in either ARC's December 31, 1974, consolidated financial statement, or in Reserve's separate financial statement for that year.

40. Andersen and each of the defendants who was an officer or director of ARC or Reserve at the time ARC's December 31, 1974, consolidated financial statement was published, knew that the statement did not fully disclose the negotiations concerning, the purposes of, and the reasons which led to the execution of the consent agreement and the potentially adverse effects on ARC, Reserve and Market. Moreover, each of the defendants who was an officer or director of Reserve at the time its National Association of Insurance Commissioners ("NAIC") Convention Statement for that year was filed with the insurance departments of the states in which it was doing business were aware that the existence and effects of the consent agreement were not fully disclosed in that statement.

41. Notwithstanding that the Illinois Department entered into the consent agreement which permitted Reserve to continue to write insurance subject to the restrictions therein, if the Illinois Department had known that Reserve was insolvent, the Illinois Department would not have permitted Reserve to continue to write insurance, but would have caused Reserve to stop writing insurance pursuant to ch. 73, § 756.1, Ill. Rev. Stat. The SCOR arrangement, along with ARC's consolidated financial statement of December 31, 1974, and Reserve's separate financial statement for the same year, both prepared by Andersen, concealed Reserve's insolvency.

42. Moreover, the SCOR arrangement later allowed ARC to transfer more than $3,000,000 of Reserve's income through SCOR to GRC, which, in turn, transferred it to ARC in the form of dividends and loans. ARC, itself insolvent by this time, needed these funds to avoid default on its own debt obligations. Reserve could not have transferred these funds

directly to ARC because of the provisions of the consent agreement with the Illinois Department. As a result, a substantial part of the income from Reserve's most profitable business was diverted to ARC, rather than being retained in Reserve to help offset the disastrous underwriting and investment losses that Reserve was suffering. Upon information and belief, SCOR and SCOR Reinsurance knew that monies SCOR had paid to GRC in connection with its retrocession were being directed to ARC. GRC and Managers knew that monies SCOR had paid to GRC in connection with the retrocession were being directed to ARC.

43. With the knowledge and approval of all the defendants who were then officers and directors of ARC and Reserve, ARC and Reserve prepared, published, and filed with the Illinois Department: (a) ARC's consolidated financial statements for the years ending December 31, 1974, 1975, 1976 and 1977, and (b) NAIC Convention Statements for Reserve and Market for the years ending December 31, 1974, 1975, 1976 and 1977. None of these annual reports and convention statements disclosed, *inter alia:* (1) that the SCOR arrangement was entered into to conceal Reserve's insolvency, (2) that the SCOR arrangement did not remove any substantial risk of loss from the ARC insurance group and was no more than a financing scheme, (3) that the SCOR arrangement had been used to evade the consent agreement between Reserve and Market and the Illinois Department, (4) that the approval of the SCOR arrangement was obtained by concealing from the Illinois Department the retrocession and guarantee aspects of the arrangement, (5) that Reserve was at all times insolvent, and (6) that the SCOR arrangement resulted in Reserve not only being able to continue to write a significant amount of high risk business while insolvent, but also being left with the least profitable and most risky of that business.

44. Andersen, Coopers and Grant each knew that Reserve was at all times insolvent and each knew of the existence of the SCOR arrangement, the reasons for it, and the effects of

it, but each of them provided unqualified opinion letters as to ARC's consolidated financial statements for the years 1974, 1975, 1976 and 1977, and Reserve's and Market's NAIC Convention Statements for the years 1974, 1975, 1976 and 1977, even though those financial statements, while containing footnotes concerning reinsurance and parent company guarantees, failed to disclose, *inter alia*: (1) that the SCOR arrangement was entered into to conceal Reserve's insolvency, (2) that the SCOR arrangement did not remove any substantial risk of loss from the ARC insurance group and was no more than a financing scheme, (3) that the SCOR arrangement had been used to evade the consent agreement between Reserve and Market and the Illinois Department, (4) that the approval of the SCOR arrangement was obtained by concealing from the Illinois Department the retrocession and guarantee aspects of the arrangement, (5) that Reserve was at all times insolvent, and (6) that the SCOR arrangement resulted in Reserve not only being able to continue to write a significant amount of high risk business while insolvent, but also being left with the least profitable and most risky of that business.

45. In late 1974, ARC sought to purchase all of the assets of Triumph American, Inc. ("Triumph"), including all of the outstanding shares of stock of Resolute Insurance Company ("RIC"). At that time, RIC owned all of the outstanding shares of stock of Resolute Life Insurance Company ("RLIC").

46. On February 5, 1975, the Department of Business Regulation, Insurance Division, of Rhode Island, which had regulatory authority over RIC and RLIC, gave its approval to ARC's purchase of all the outstanding shares of stock of RIC.

47. In November, 1975, ARC reorganized its insurance subsidiaries. As part of that reorganization, RIC's name was changed to American Reserve Insurance Company ("ARIC") and RLIC's name was changed to American Reserve Life Insurance Company ("ARLIC"). In addition, all the outstanding shares of stock of ARLIC were sold by ARIC to

Resolute Investment Corporation ("Resolute"), a wholly-owned subsidiary of ARC, for $2,300,000 and all the outstanding shares of stock of ARIC were sold by Resolute to ARLIC for $2,300,000. Finally, ARLIC paid a dividend of $3,286,331 to ARIC, and ARC transferred all of the outstanding shares of stock of Reserve to ARIC. This transfer of Reserve stock to ARIC occurred on November 28, 1975, and completed the reorganization.

48. By means of this reorganization, ARC "pyramided" its operating companies so that Market was a wholly-owned subsidiary of Reserve, Reserve a wholly-owned subsidiary of ARIC, ARIC a wholly-owned subsidiary of ARLIC, ARLIC a wholly-owned subsidiary of Resolute, and Resolute a wholly-owned subsidiary of ARC. The relevant portions of ARC's corporate structure after the reorganization are shown on the chart attached hereto as Exhibit "C". This "pyramiding" resulted in each operating company including within its own surplus the surplus of its subsidiaries. This, in turn, permitted the ARC group to continue to write a high volume of business while each operating company appeared to be within the safe range of leverage, *i.e.*, having a ratio of premiums to surplus of less than 4 to 1.

49. Subsequent to the reorganization in November, 1975, ARC, with the knowledge and approval of each defendant who was, from time to time, an officer and director of ARC or Reserve, continued to conceal Reserve's insolvency. This was accomplished by the methods already detailed above and by, *inter alia*, taking the following new actions: (1) instituting a conscious policy of delaying the payment of all claims, no matter how obvious their merit, (2) understating the reserves that were necessary to satisfy claims and claims administration expenses in ARC's consolidated financial statements for the years ending December 31, 1975, 1976 and 1977, (3) continuing to reflect Reserve's cessions of insurance in its NAIC Convention Statements for the years ending December 31, 1975, 1976 and 1977, even though such cessions should not have been reflected due to the potential effect on surplus if

those reinsurance agreements were cancelled, (4) misstating the effect of such cancellation in the reinsurance interrogatories contained in those Convention Statements, and (5) failing to disclose the effect of the "pyramiding" of ARC's operating subsidiaries in the consolidated financial statements and Reserve's NAIC Convention Statements.

49.1. Andersen, Coopers and Grant each knew subsequent to the reorganization in November, 1975, that ARC through its officers and directors continued to conceal Reserve's insolvency. They knew this was accomplished by the methods already detailed above and by, *inter alia*, the following new actions: (1) instituting a conscious policy of delaying the payment of all claims, no matter how obvious their merit, (2) understating the reserves that were necessary to satisfy claims and claims administration expenses in ARC's consolidated audited financial statements for the years ending December 31, 1975, 1976 and 1977, (3) continuing to reflect Reserve's cessions of insurance in its NAIC Convention Statements for the years ending December 31, 1975, 1976, and 1977, even though such cessions should not have been reflected due to the potential effect on surplus if those reinsurance agreements were cancelled, (4) misstating the effect of such cancellation in the reinsurance interrogatories contained in those Convention Statements, and (5) failing to disclose the effect of the "pyramiding" of ARC's operating subsidies in the consolidated financial statements and Reserve's NAIC Convention Statements.

50. The defendants who were then officers and directors of ARC and Reserve either prepared, assisted in preparing, or approved ARC's 1975, 1976 and 1977 consolidated financial statements for Reserve, even though those statements did not disclose the above actions taken subsequent to the reorganization to conceal Reserve's insolvency. Moreover, Andersen, Coopers and Grant were each aware that Reserve's insolvency was being so concealed; nonetheless Andersen gave an unqualified opinion letter on the 1975

ARC consolidated financial statement; Coopers gave an unqualified opinion letter on the 1976 ARC consolidated financial statement; and Grant gave an unqualified opinion letter on the 1977 ARC consolidated financial statement, and an opinion letter unqualified as to the actions being taken to conceal Reserve's insolvency on the 1976 and 1977 Reserve financial statements. None of those statements disclosed the actions being taken to conceal Reserve's insolvency.

51. By December, 1976, ARC was underreserved for potential and actual claims and claims administration expenses from its prior years' insurance business by an amount in excess of $50,000,000. Most of that deficiency was in Market and Reserve, which had been left with the least profitable and most risky insurance business as a result of the SCOR arrangement.

52. During 1974 and 1975, Andersen knew that ARC's and Reserve's reserves for current and prior years' insurance claims and claims administration expenses were grossly inadequate; but Andersen issued an unqualified opinion letter as to ARC's 1974 and 1975 consolidated financial statements, and as to Reserve's separate financial statement for 1974, even though those financial statements failed to provide adequate reserves and thereby incorrectly stated ARC's and Reserve's income and net equity at December 31, 1974, and December 31, 1975, respectively.

53. During 1976, Coopers knew that ARC's and Reserve's reserves for current and prior years' insurance claims and claims administration expenses were grossly inadequate. In fact, Coopers did a study of those reserves which indicated that they needed to be increased by $23,000,000, and that the effect of such an increase would be to render ARC insolvent and reveal Reserve's insolvency. However, Coopers issued an unqualified opinion letter as to ARC's 1976 consolidated financial statement even though the financial statement added only $5,500,000 of the $23,000,000 which Coopers had concluded was necessary, and thereby incorrectly stated

ARC's and Reserve's income and net equity at December 31, 1976.

54. During 1976 and 1977, Grant knew that ARC's and Reserve's reserves for current and prior years' insurance claims and claims administration expenses were grossly inadequate. However, Grant issued an unqualified opinion letter as to ARC's 1977 consolidated financial statement even though the financial statement failed to provide adequate reserves and thereby incorrectly stated ARC's and Reserve's income and net equity at December 31, 1977. Moreover, Grant also issued opinion letters, unqualified as to either (a) reserves for claim and claims administration expenses, (b) the volume of premiums written, or (c) the amount of income, with respect to Reserve's separate financial statements for the years ending December 31, 1976, and 1977, even though those financial statements (a) failed to provide adequate reserves, (b) improperly deducted premiums ceded to reinsurers and (c) improperly reflected commission income from unearned premiums ceded to reinsurers.

55. ARC's consolidated audited financial statements for the years ending December 31, 1975, 1976 and 1977, were submitted to the Illinois Department. The audited statements for Reserve for the years ending December 31, 1976 and 1977, were also submitted to the Illinois Department. Andersen, Coopers and Grant knew that all of these financial statements were required to be filed with the Illinois Department.

56. In the fall of 1977 Grant concluded that the SCOR arrangement did not transfer any risk of loss to SCOR and that that arrangement was not true reinsurance, but a financing arrangement. Grant raised this issue with Stenhouse and other officers and directors of ARC. ARC then negotiated an amendment to the SCOR arrangement so that SCOR would assume a minor risk if the loss ratio on the ceded insurance exceeded 75%. Grant then agreed to treat the SCOR arrangement as true reinsurance even though the probability of the loss ratio exceeding 75% was all but nonexistent due to the

fact that these cessions consisted of Reserve's most profitable and least risky business and had an historical loss ratio of less than 75%. As a result, Grant rendered an unqualified opinion as to ARC's 1977 consolidated financial statement even though the statement treated the SCOR arrangement as true reinsurance, did not properly disclose the real nature and effect of that arrangement, and did not disclose that Reserve was actually insolvent.

57. If the true financial situation of ARC and Reserve had not been continually concealed by the use of the SCOR arrangement, by the concealment of the nature, purpose and effects of that arrangement, by the understatement of reserves, by the institution of the aforementioned claims payment policy, by the "pyramiding" of ARC's operating subsidiaries, by the issuance of inaccurate financial statements and by the payment of excessive dividends by Reserve to ARC, the Illinois Department would not have permitted Reserve to continue to write insurance, pursuant to ch. 73, § 756.1, Ill. Rev. Stat.

58. Sometime in 1978, the Securities Exchange Commission (hereinafter referred to as "SEC") commenced an investigation of ARC, including the SCOR arrangement and the failure of ARC to disclose both its existence and effect upon Reserve in the reports ARC filed with the SEC.

59. When ARC and its then officers and directors learned that the SEC was investigating the SCOR arrangement, they terminated the arrangement, effective as of September, 1978.

60. The SEC found, as part of its proceedings and order, that:

> "3. In late 1974, Reserve and Market obtained the approval of the Director of the Illinois Department of Insurance to enter into the above cession to Reinsurer. Since ARC believed that the elements of the arrangement not involving Reserve and Market did not require approval of the cession ARC did not inform that Department of the existence of the retrocession to GRC or of

ARC's guarantee of its subsidiaries' performance under the arrangement.

4. ARC filed with the Commission Annual Reports on Form 10K for its fiscal year ended December 31, 1974, through December 31, 1977, which failed in material respects to disclose the arrangement with reinsurer and to make specific reference to its potential impact on ARC."

(A copy of the complete finding, opinion and order of the SEC is attached hereto as Exhibit "D").

61. By the time that Grant completed its work in February or March, 1979, on the audit of ARC's, Reserve's and Market's financial statements for the year ending December 31, 1978, the losses suffered on prior years' insurance business had so far exceeded existing reserves that ARC and Reserve, and their officers and directors, had no choice but to disclose that Reserve was insolvent.

COUNT I

Civil Conspiracy Claim Against Officers and Directors, SCOR, SCOR Reinsurance, GRC and Managers

62. Plaintiff repeats and realleges the foregoing paragraphs 25 through 61, inclusive, as paragraph 62 of this Count I of the Complaint.

63. The officers and directors, GRC and Managers knew that the arrangement with SCOR established by the agreements was not true reinsurance but a financing arrangement. The officers and directors, GRC and Managers knew that at the time the agreements described above were entered into and until the agreements were terminated, that Reserve was insolvent, and that SCOR by virtue of the agreements assumed the remaining profitable business of Reserve at no risk to SCOR. The officers and directors, GRC and Managers knew that the agreements were later used to allow ARC, Reserve's parent corporation, to transfer more than $3,000,000 of Reserve's income through SCOR to GRC which, in turn, transferred that income to ARC in the form of dividends or loans, in spite of the fact that such acts were in

contravention of the consent agreement entered into with the Illinois Department and ch. 32, § 157.42-1, Ill. Rev. Stat. The officers and directors knew that by entering into the agreements with SCOR they were violating their fiduciary duties as officers and directors of Reserve, and as officers and directors of ARC, Reserve's parent corporation.

64. The officers and directors caused ARC, Reserve and Market to enter into the SCOR arrangement with the intent of concealing and obscuring Reserve's insolvent financial condition from Reserve, its policyholders, creditors and shareholders, and the Illinois Department; with the intent of lulling Reserve, its policyholders, creditors and shareholders, and the Illinois Department into believing that Reserve's financial condition was stabilizing or actually improving; and with the intent of allowing Reserve to continue to write insurance and incur additional liabilities, notwithstanding that Reserve was at all relevant times insolvent, in violation of ch. 73, §756.1, Ill. Rev. Stat. GRC and Managers knew that the officers and directors caused ARC, Reserve and Market to enter into the SCOR arrangement for the above purposes.

65. SCOR and SCOR Reinsurance knew that the SCOR arrangement with ARC, Reserve, Market and GRC was not true reinsurance but a financing arrangement. SCOR and SCOR Reinsurance knew at the time the agreements described above were entered into, and until the agreements were terminated, that Reserve was insolvent, and that SCOR by virtue of the agreements assumed the remaining profitable business of Reserve at no risk to SCOR. SCOR and SCOR Reinsurance knew that the agreements were later used to allow ARC, Reserve's parent corporation, to transfer more than $3,000,000 of Reserve's income through SCOR to GRC which, in turn, transferred that income to ARC in the form of dividends or loans, in spite of the fact that such acts were in contravention of the consent agreement entered into with the Illinois Department and ch. 32, § 157.42-1, Ill. Rev. Stat. SCOR and SCOR Reinsurance, as well as GRC and Managers, knew that the officers and directors violated their fiduciary duties as officers and directors of Reserve, and as

officers and directors of ARC, Reserve's parent corporation, by entering into the agreements.

66. As an alternative to paragraph 65, above, plaintiff alleges the following. SCOR and SCOR Reinsurance should have known that the SCOR arrangement with ARC, Reserve, Market and GRC was not true reinsurance but a financing arrangement. SCOR and SCOR Reinsurance should have known at the time the agreements described above were entered into and until the agreements were terminated, that Reserve was insolvent, and that SCOR by virtue of the agreements was assuming the remaining profitable business of Reserve at no risk to SCOR. SCOR and SCOR Reinsurance should have known that the agreements were later used to allow ARC, Reserve's parent corporation, to transfer more than $3,000,000 of Reserve's income through SCOR to GRC which, in turn, transferred that income to ARC in the form of dividends or loans, in spite of the fact that such acts were in contravention of the consent agreement entered into with the Illinois Department and ch. 32, § 157.42-1, Ill. Rev. Stat. SCOR and SCOR Reinsurance, as well as GRC and Managers, should have known that the officers and directors violated their fiduciary duties as officers and directors of Reserve, and as officers and directors of ARC, Reserve's parent corporation, by entering into the agreements.

67. SCOR and SCOR Reinsurance knew that the officers and directors caused ARC, Reserve and Market to enter into the SCOR arrangement with the intent of concealing and obscuring Reserve's insolvent financial condition from Reserve, its policyholders, creditors and shareholders, and the Illinois Department; with the intent of lulling Reserve, its policyholders, creditors and shareholders, and the Illinois Department into believing that Reserve's financial condition was stabilizing or actually improving; and with the intent of allowing Reserve to continue to write insurance and incur additional liabilities, notwithstanding that Reserve was at all relevant times insolvent, in violation of ch. 73, § 756.1, Ill. Rev. Stat.

68. As an alternative to paragraph 67, above, plaintiff alleges the following. SCOR and SCOR Reinsurance should have known that the officers and directors caused ARC, Reserve and Market to enter into the SCOR arrangement with the intent of concealing and obscuring Reserve's insolvent financial condition from Reserve, its policyholders, creditors and shareholders, and from the Illinois Department; with the intent of lulling Reserve, its policyholders, creditors and shareholders, and the Illinois Department into believing that Reserve's financial condition was stabilizing or actually improving; and with the intent of allowing Reserve to continue to write insurance and incur additional liabilities notwithstanding that Reserve was at all relevant times insolvent, in violation of ch. 73, § 756.1, Ill. Rev. Stat.

69. Pursuant to the above conduct on the part of the officers and directors, GRC and Managers, and the above alternative conduct of SCOR and SCOR Reinsurance, the officers and directors, SCOR, SCOR Reinsurance, GRC and Managers confederated, combined and formed themselves into a conspiracy for the particular unlawful purposes of concealing and obscuring Reserve's insolvent financial condition from Reserve, its policyholders, creditors and shareholders, and the Illinois Department; of violating ch. 73, § 756.1, Ill. Rev. Stat.; of violating ch. 32, § 157.42-1, Ill. Rev. Stat.; and for the additional purpose of causing the officers and directors to breach their fiduciary duties as officers and directors of Reserve, and as officers and directors of ARC, Reserve's parent corporation.

70. The above conduct on the part of the officers and directors, GRC and Managers, and the above alternative conduct of SCOR and SCOR Reinsurance constituted overt acts in furtherance of the conspiracy.

71. As a direct result of the conspiracy entered into between the officers and directors, SCOR, SCOR Reinsurance, GRC and Managers and the unlawful purposes advanced by said conspiracy, Reserve continued to write insurance and was caused to incur additional liabilities, and

Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor and against the officers and directors, SCOR, SCOR Reinsurance, GRC and Managers, jointly and severally, in such amount as is determined to be due and owing.

COUNT II

RICO Claim Against Officers And Directors, SCOR, SCOR Reinsurance, GRC and Managers

72. Plaintiff repeats and realleges the foregoing paragraphs 25 through 61, inclusive, and 63 through 70, inclusive, but not paragraphs 66 and 68, as paragraph 72 of this Count II of the Complaint.

73. The above conspiracy constituted an intentional scheme on the part of the officers and directors, SCOR, SCOR Reinsurance, GRC and Managers to defraud Reserve, its policyholders, creditors and shareholders, and the Illinois Department, which was carried out by the intentional use of false or fraudulent misrepresentations or omissions made for the purpose of gaining valuable undue advantages and working an injury to Reserve.

74. Pursuant to the scheme to defraud, the officers and directors allowed ARC to gain a valuable advantage in that ARC was able to transfer more than $3,000,000 of Reserve's income through SCOR to GRC which, in turn, transferred that income to ARC in the form of dividends and loans, in spite of the fact that such acts were in contravention of the consent agreement with the Illinois Department and ch. 32, § 157.42-1, Ill. Rev. Stat. The scheme to defraud also further

increased Reserve's liabilities while Reserve was insolvent, thereby injuring Reserve.

75. Pursuant to the scheme to defraud, SCOR gained a valuable advantage in that SCOR assumed the remaining profitable business of Reserve at no risk to SCOR, with the result that SCOR siphoned off the income from Reserve's most profitable business. The scheme to defraud further increased Reserve's liabilities while Reserve was insolvent, thereby injuring Reserve.

76. The United States mails was used in furtherance of the scheme to defraud by the officers and directors, SCOR, SCOR Reinsurance, GRC and Managers, to the detriment of Reserve, on or about the following dates in violation of 18 U.S.C. § 1341 for, *inter alia,* the purpose of transmitting the indicated intentionally inaccurate and fraudulent financial statements which concealed the nature and effect of the SCOR arrangement and the insolvent financial condition of Reserve:

Year of Statement	Company	Date of Mailing
12-31-74	ARC	3-25-75
12-31-74	Reserve	3-25-75
12-31-75	ARC	3-29-76
12-31-76	ARC	3-29-77
12-31-76	Reserve	7-29-77
12-31-77	ARC	3-10-78
12-31-77	Reserve	3-10-78

Upon information and belief, the United States mails was further used by the officers and directors, SCOR, SCOR Reinsurance, GRC and Managers in furtherance of the scheme to defraud, to the detriment of Reserve, throughout the lifetime of the SCOR arrangement and negotiations leading thereto to transmit texts of the agreements, commissions and other materials.

77. The above described use of the mails constituted a pattern of racketeering activity pursuant to 18 U.S.C. §§ 1341, 1961(1), (5).

78. The officers and directors, SCOR, SCOR Reinsurance, GRC and Managers used income derived from the above described pattern of racketeering activity in the operation of ARC, SCOR, SCOR Reinsurance, GRC and Managers respectively, each being an enterprise engaged in activities which affect interstate and foreign commerce, in violation of 18 U.S.C. § 1962(a).

79. The officers and directors, SCOR, SCOR Reinsurance, GRC and Managers conducted the affairs of ARC, SCOR, SCOR Reinsurance, GRC and Managers respectively, through the pattern of racketeering activity described above, each being an enterprise engaged in activities which affect interstate and foreign commerce, in violation of 18 U.S.C. § 1962(c).

80. All of the above described activity of the officers and directors, SCOR, SCOR Reinsurance, GRC and Managers was undertaken intentionally and with full knowledge and appreciation of the results described.

81. As a direct result of the intentional scheme to defraud, the use of the United States mails in its furtherance, and the above described pattern of racketeering activity, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor and against the officers and directors, SCOR, SCOR Reinsurance, GRC and Managers, jointly and severally, in such amount as is determined to be due and owing, and that the amount of said judgment be trebled and that plaintiff be awarded attorneys' fees and costs, all pursuant to 18 U.S.C. § 1964(c).

COUNT III

Civil Conspiracy Claim Against Officers And Directors And Andersen, Coopers and Grant

82. Plaintiff repeats and realleges the foregoing paragraphs 25 through 61, inclusive, as paragraph 82 of this Count III of the Complaint.

83. The officers and directors and Andersen, Coopers and Grant knew that ARC's consolidated financial statements for the years ending December 31, 1974, 1975, 1976 and 1977, and the NAIC Convention Statements for Reserve and Market for the years ending December 31, 1974, 1975, 1976 and 1977 failed to disclose, *inter alia*: (1) that the SCOR arrangement was entered into to conceal Reserve's insolvency, (2) that the SCOR arrangement did not remove any substantial risk of loss from the ARC insurance group and was no more than a financing scheme, (3) that the SCOR arrangement had been used to evade the consent agreement between Reserve and Market and the Illinois Department, (4) that the approval of the SCOR arrangement was obtained by concealing from the Illinois Department the retrocession and guarantee aspects of the arrangement, (5) that Reserve was at all times insolvent, and (6) that the SCOR arrangement resulted in Reserve not only being able to continue to write a significant amount of high risk business while insolvent, but also being left with the least profitable and most risky of that business.

84. Subsequent to the reorganization in November, 1975, the officers and directors and Andersen, Coopers and Grant knew that Reserve's insolvency was continuing to be concealed from Reserve, its policyholders, creditors and shareholders, and the Illinois Department, by the methods already detailed above and by the following new actions, *inter alia*: (1) instituting a conscious policy of delaying the payment of all claims, no matter how obvious their merit, in violation of ch. 73, §§ 766.5-767, Ill. Rev. Stat., (2) understating the reserves that were necessary to satisfy claims and

claims administration expenses in ARC's consolidated audited financial statements for the years ending December 31, 1975, 1976 and 1977, (3) continuing to reflect Reserve's cessions of insurance in its NAIC Convention Statements for the years ending December 31, 1975, 1976 and 1977, even though such cessions should not have been reflected due to the potential effect on surplus if those reinsurance agreements were cancelled, (4) misstating the effect of such cancellation in the reinsurance interrogatories contained in those Convention Statements, (5) failing to disclose the effects of the "pyramiding" of ARC's operating subsidies, and (6) incorrectly stating ARC's and Reserve's income and net equity in ARC's consolidated financial statements for the years ending December 31, 1975, 1976 and 1977.

85. The officers and directors and Andersen, Coopers and Grant undertook all of the above acts and omissions with the intent of concealing and obscuring Reserve's insolvent financial condition from Reserve, its policyholders, creditors and shareholders and the Illinois Department; with the intent of lulling Reserve, its policyholders, creditors and shareholders, and the Illinois Department into believing that Reserve's financial condition was stabilizing or actually improving; and with the intent of allowing Reserve to continue to write insurance and incur additional liabilities notwithstanding that Reserve was at all relevant times insolvent, in violation of ch. 73, § 756.1, Ill. Rev. Stat.

86. Pursuant to the above conduct on the part of the officers and directors and Andersen, Coopers and Grant, the officers and directors and Andersen, Coopers and Grant confederated, combined and formed themselves into a conspiracy for the particular unlawful purposes of concealing and obscuring Reserve's insolvent condition from Reserve, its policyholders, creditors and shareholders, and the Illinois Department; of violating ch. 73, § 756.1, Ill. Rev. Stat.; of violating ch. 32, § 157.42-1, Ill. Rev. Stat.; causing the officers and directors to breach their fiduciary duties as officers and directors of Reserve and officers and directors of ARC,

Reserve's parent corporation; and causing Andersen, Coopers and Grant to breach their fiduciary duties as auditors of ARC and Reserve.

87. The above conduct on the part of the officers and directors and Andersen, Coopers and Grant constituted overt acts in furtherance of the conspiracy.

88. As a direct result of the conspiracy entered into by the officers and directors and Andersen, Coopers and Grant and the unlawful purposes advanced by said conspiracy, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor and against the officers and directors and Andersen, Coopers and Grant, jointly and severally, in such amount as is determined to be due and owing.

COUNT IV

RICO Claim Against Officers And Directors And Andersen, Coopers and Grant

89. Plaintiff repeats and realleges the foregoing paragraphs 25 through 61, inclusive, and 83 through 87, inclusive, as paragraph 89 of this Count IV of the Complaint.

90. The above conspiracy constituted an intentional scheme on the part of the officers and directors and Andersen, Coopers and Grant to defraud Reserve, its policyholders, creditors and shareholders, and the Illinois Department, which was carried out by the intentional use of false or fraudulent misrepresentations or omissions made for the

purpose of gaining undue advantages and working an injury to Reserve.

91. Pursuant to the scheme to defraud, the officers and directors gained a valuable advantage in that they were able to keep Reserve operating and writing insurance to ARC's benefit and the benefit of those defendants who were officers of ARC and Reserve and continued to receive compensation as officers. The scheme to defraud also further increased Reserve's liabilities while Reserve was insolvent, thereby injuring Reserve.

92. Pursuant to the scheme to defraud, Andersen, Coopers and Grant gained a valuable advantage in that Andersen, Coopers and Grant were able to keep ARC and Reserve operating and writing insurance and Andersen, Coopers and Grant received fees for their services as accountants and auditors. The scheme to defraud also further increased Reserve's liabilities while Reserve was insolvent, thereby injuring Reserve.

93. The United States mails was used in furtherance of the scheme to defraud by the officers and directors and Andersen, Coopers and Grant, to the detriment of Reserve, on or about the following dates in violation of 18 U.S.C. § 1341, for, *inter alia*, transmitting the indicated intentionally inaccurate and fraudulent financial statements which concealed the insolvent financial condition of Reserve:

Year of Statement	Company	Date of Mailing
12-31-74	ARC	3-25-75
12-31-74	Reserve	3-25-75
12-31-75	ARC	3-29-76
12-31-76	ARC	3-29-77
12-31-76	Reserve	7-29-77
12-31-77	ARC	3-10-78
12-31-77	Reserve	3-10-78

94. The above described use of the mails constituted a pattern of racketeering activity pursuant to 18 U.S.C. §§ 1341, 1961(1), (5).

95. The officers and directors and Andersen, Coopers and Grant used income derived from the above described pattern of racketeering activity in the operation of ARC, Andersen, Coopers and Grant respectively, each of these enterprises being engaged in activities which affect interstate and foreign commerce, in violation of 18 U.S.C. § 1962(a).

96. The officers and directors and Andersen, Coopers and Grant conducted the affairs of ARC, Andersen, Coopers and Grant respectively, through the pattern of racketeering activity described above, each of these enterprises being engaged in activities which affect interstate and foreign commerce, in violation of 18 U.S.C. § 1962(c).

97 All of the above described activity of the officers and directors and Andersen, Coopers and Grant was undertaken intentionally and with full knowledge and appreciation of the results described.

98. As a direct result of the intentional scheme to defraud, the use of the United States mails in its furtherance and the above described pattern of racketeering activity, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor and against the officers and directors and Andersen, Coopers and Grant, jointly and severally, in such amount as is determined to be due and owing, and that the amount of said judgment be trebled and that plaintiff be

awarded attorneys' fees and costs, all pursuant to 18 U.S.C. § 1964(c).

COUNT V

Breach of Fiduciary Duty Claim Against Officers and Directors

99. Plaintiff repeats and realleges the foregoing paragraphs 25 through 61, inclusive, as paragraph 99 of this Count V of the Complaint.

100. Each of the officers and directors owed a fiduciary duty to Reserve, as officers and directors of Reserve, and as officers and directors of ARC, Reserve's parent corporation, to administer Reserve's affairs for the common benefit of Reserve, its policyholders, creditors and shareholders and to exercise their best care, skill and judgment in the management of the corporate business solely in the interest of Reserve.

101. The officers and directors failed to discharge their fiduciary duty to Reserve in that, *inter alia*, they:

(a) Failed to keep correct and accurate books and records of accounts for Reserve in violation of ch. 32, § 157.45, Ill. Rev. Stat. and ch. 73, § 745, Ill. Rev. Stat.;

(b) Instituted a conscious policy of delaying the payment of all claims, no matter how obvious their merit, in violation of ch. 73, §§ 766.5-767, Ill. Rev. Stat.;

(c) Knowingly understated the reserves that were necessary to satisfy claims and claims administration expenses in ARC's consolidated audited financial statements for the years ending December 31, 1974, 1975, 1976 and 1977;

(d) Failed to disclose the nature, reasons and effect of the SCOR arrangement in those financial statements;

(e) Reflected Reserve's cessions of insurance in its NAIC Convention Statements for the years ending December 31, 1975, 1976, and 1977, even though such cessions should not have been reflected due to the potential effect on surplus if those reinsurance agreements were cancelled;

(f) Knowingly misstated the effect of such cancellation in the reinsurance interrogatories contained in those Convention Statements;

(g) Permitted Reserve to continue to write insurance, dissipate its assets and assume additional liabilities even though Reserve was insolvent at least as of December 31, 1974;

(h) Allowed ARC to transfer more than $3,000,000 of Reserve's income through SCOR to GRC which, in turn, transferred that income to ARC in the form of dividends or loans, in spite of the fact that such acts were in contravention of the consent agreement with the Illinois Department and ch. 32, § 157.42-1, Ill. Rev. Stat;

(i) Failed to report accurately the foregoing acts, omissions and circumstances to the Illinois Department as required by the Illinois Insurance Code, ch. 73, §§ 613, *et seq.,* Ill. Rev. Stat., and particularly ch. 73, §§ 745, 746 and 748, Ill. Rev. Stat.

102. As a direct result of the officers' and directors' foregoing breaches of their fiduciary duties owed to Reserve, as officers and directors of Reserve, and as officers and directors of ARC, Reserve's parent corporation, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor and against the officers and directors, jointly and severally, in such amount as is determined to be due and owing.

COUNT VI

Willful, Wanton And Intentional Breach Of Fiduciary Duty Claim Against Officers And Directors—Punitive Damages

103. Plaintiff repeats and realleges the foregoing paragraphs 99 through 102, inclusive, as paragraph 103 of this Count VI, of the Complaint.

104. Each of the foregoing acts or omissions of the officers and directors constituting a breach of their fiduciary duties was willful, wanton and intentional and was made with total disregard for its consequences, and plaintiff is entitled to an additional award of punitive damages in the amount of $200,000,000.

WHEREFORE, plaintiff prays that this court enter judgment in his favor and against the officers and directors, jointly and severally, in the amount of $200,000,000, plus costs.

COUNT VII

Negligent Mismanagement Claim Against Officers And Directors

105. Plaintiff repeats and realleges the foregoing paragraphs 25 through 61, inclusive, as paragraph 105 of this Count VII of the Complaint.

106. Each of the officers and directors owed a duty to Reserve as officers and directors of Reserve, or as officers and directors of ARC, Reserve's parent corporation, to use ordinary care in the discharge of their management duties.

107. Defendants and each of them breached their aforesaid duties in that, *inter alia*, they:

(a) Failed to keep correct and accurate books and records of accounts for Reserve in violation of ch. 32, § 157.45, Ill. Rev. Stat. and ch. 73, § 745, Ill. Rev. Stat.;

(b) Instituted a conscious policy of delaying the payment of all claims, no matter how obvious their merit, in violation of ch. 73, §§ 766.5-767, Ill. Rev. Stat.;

(c) Knowingly understated the reserves that were necessary to satisfy claims and claims administration expenses in ARC's consolidated audited financial statements for the years ending December 31, 1974, 1975, 1976 and 1977;

(d) Failed to disclose the nature, reasons and effect of the SCOR arrangement in those financial statements;

(e) Reflected Reserve's cessions of insurance in its NAIC Convention Statements for the years ending December 31, 1975, 1976 and 1977, even though such cessions should not have been reflected due to the potential effect on surplus if those reinsurance agreements were cancelled;

(f) Knowingly misstated the effect of such cancellation in the reinsurance interrogatories contained in those Convention Statements;

(g) Permitted Reserve to continue to write insurance, dissipate its assets and assume additional liabilities even though Reserve was insolvent since at least as of December 31, 1974;

(h) Allowed ARC to transfer more than $3,000,000 of Reserve's income through SCOR to GRC which, in turn, transferred that income to ARC in the form of dividends or loans, in spite of the fact that such acts were in contravention of the consent agreement with the Illinois Department and ch. 32, § 157.42-1, Ill. Rev. Stat.;

(i) Failed to report accurately the foregoing acts, omissions and circumstances to the Illinois Department as required by the Illinois Insurance Code, ch. 73, §§ 613, *et seq.*, Ill. Rev. Stat., and particularly ch. 73, § 745, 746 and 748, Ill. Rev. Stat.

108. As a direct and proximate result of the failure of the officers and directors to exercise ordinary care in the discharge of their management duties, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

109. At all relevant times herein Reserve exercised due care on its own part and was free from contributory negligence.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor, and against the officers and directors, jointly and severally, in such amount as is determined to be due and owing.

COUNT VIII

Willful, Wanton and Intentional Mismanagement Claim Against Officers And Directors—Punitive Damages

110. Plaintiff repeats and realleges the foregoing paragraphs 105 through 108, inclusive, as paragraph 110 of this Count VIII of the Complaint.

111. Each of the foregoing acts or omissions of the officers and directors constituting mismanagement was willful, wanton and intentional and made with total disregard for its consequences and plaintiff is entitled to an additional award of punitive damages in the amount of $200,000,000.

112. At all relevant times herein Reserve was free from willful, wanton and intentional misconduct on its own part.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor and against the officers and directors, jointly and severally, in the amount of $200,000,000, plus costs.

COUNT IX

Fraud Claim Against Officers And Directors—Compensatory and Punitive Damages

113. Plaintiff repeats and realleges the foregoing paragraphs 25 through 61, inclusive, as paragraph 113 of this Count IX of the Complaint.

114. The officers and directors knowingly and willfully committed, *inter alia*, each of the following misrepresentations or omissions of existing facts with the intent of representing that Reserve was solvent, and concealing Reserve's insolvency:

(a) Failed to keep correct and accurate books and records of accounts for Reserve in violation of ch. 32, § 157.45, Ill. Rev. Stat. and ch. 73, § 745, Ill. Rev. Stat.;

(b) Instituted a conscious policy of delaying the payment of all claims, no matter how obvious their merit, in violation of ch. 73, §§ 766.5-767, Ill. Rev. Stat.;

(c) Knowingly understated the reserves that were necessary to satisfy claims and claims administration expenses in ARC's consolidated audited financial statements for the years ending December 31, 1974, 1975, 1976 and 1977;

(d) Failed to disclose the nature, reasons and effect of the SCOR agreements in those financial statements;

(e) Reflected Reserve's cessions of insurance in its NAIC Convention Statements for the years ending

December 31, 1975, 1976 and 1977, even though such cessions should not have been reflected due to the potential effect on surplus if those reinsurance agreements were cancelled;

(f) Knowingly misstated the effect of such cancellation in the reinsurance interrogatories contained in those Convention Statements;

(g) Permitted Reserve to continue to write insurance, dissipate its assets and assume additional liabilities even though Reserve was insolvent since at least as of December 31, 1974;

(h) Allowed ARC to transfer more than $3,000,000 of Reserve's income through SCOR to GRC which, in turn, transferred that income to ARC in the form of dividends or loans, in spite of the fact that such acts were in contravention of the consent agreement with the Illinois Department and ch. 32, § 157.42-1, Ill. Rev. Stat.;

(i) Failed to report accurately the foregoing acts, omissions and circumstances to the Illinois Department as required by the Illinois Insurance Code, ch. 73, §§ 613 *et seq.*, Ill. Rev. Stat., and particularly ch. 73, § 745, 746 and 748, Ill. Rev. Stat.

115. Reserve, its policyholders, creditors and shareholders and the Illinois Department justifiably relied upon the above knowing and willful misrepresentations and omissions made by the officers and directors and especially those misrepresentations included in the several financial statements referred to.

116. Defendants made the above willful misrepresentations, especially those misrepresentations included in the several financial statements referred to, knowing that they were false and intending that Reserve, its policyholders, creditors and shareholders and the Illinois Department should rely thereupon. The purpose of the knowing and willful misrepresentations was to conceal the insolvency of Reserve so that the Illinois Department, pursuant to ch. 73,

§ 756.1, Ill. Rev. Stat., would not interfere with Reserve's ability to write insurance.

117. As a direct result of the justifiable reliance of Reserve, its policyholders, creditors and shareholders and the Illinois Department, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor, and against the officers and directors, jointly and severally, in such amount as is determined to be due and owing, and further that this court make an additional award of punitive damages in the amount of $200,000,000 plus costs.

COUNT X

Breach of Contract Claim Against Andersen (1974)

118. Plaintiff repeats and realleges the foregoing paragraphs 25 through 52, inclusive, and 55 through 61, inclusive, as paragraph 118 of this Count X of the Complaint.

119. Upon information and belief, Andersen entered into a written contract with Reserve, or in the alternative Andersen entered into a written contract with ARC for the benefit of Reserve, for the purpose of auditing Reserve and preparing the ARC consolidated financial statement which would accurately disclose Reserve's financial condition as of December 31, 1974. Andersen received and accepted valuable consideration for its services in this regard.

120. Andersen breached its written contract by failing to provide an audited consolidated financial statement which

accurately reflected Reserve's financial condition as of December 31, 1974, and in particular, *inter alia*, by failing to disclose:

(a) That Reserve had established grossly inadequate reserves for current and prior years' insurance claims and claims administration expenses;

(b) That Reserve was insolvent as of December 31, 1974;

(c) The true nature of the SCOR arrangement, the reasons for it, and its effect.

121. As a direct result of Andersen's breach of its written agreement, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor, and against Andersen in such amount as is determined to be due and owing.

COUNT XI

Breach of Contract Claim Against Andersen (Reserve 1974)

122. Plaintiff repeats and realleges the foregoing paragraphs 25 through 52, and 55 through 61, inclusive, as paragraph 122 of this Count XI of the Complaint.

123. Upon information and belief, Andersen entered into a written contract with Reserve for the purpose of auditing Reserve and preparing an audited financial statement which would accurately disclose Reserve's financial condition as of December 31, 1974. This separate financial statement was

required by the consent agreement with the Illinois Department. Andersen received and accepted valuable consideration for its services in this regard.

124. Andersen breached its written contract with Reserve by failing to provide Reserve with an audited financial statement which accurately reflected Reserve's financial condition as of December 31, 1974, and in particular, *inter alia*, by failing to disclose:

(a) That Reserve had established grossly inadequate reserves for current and prior years' insurance claims and claims administration expenses;

(b) That Reserve was insolvent as of December 31, 1974;

(c) The true nature of the SCOR arrangement, the reasons for it, and its effects.

125. As a direct result of Andersen's breaches of its written agreement with Reserve, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor, and against Andersen in such amount as is determined to be due and owing.

COUNT XII

Breach of Contract Claim Against Andersen (1975)

126. Plaintiff repeats and realleges the foregoing paragraphs 25 through 52, inclusive, and 55 through 61,

inclusive, as paragraph 126 of this Count XII of the Complaint.

127. Upon information and belief, Andersen entered into a written contract with Reserve, or in the alternative Andersen entered into a written contract with ARC for the benefit of Reserve, for the purpose of auditing Reserve and preparing the ARC consolidated financial statement which would accurately disclose Reserve's financial condition as of December 31, 1975. Andersen received and accepted valuable consideration for its services in this regard.

128. Andersen breached its written contract by failing to provide an audited consolidated financial statement which accurately reflected Reserve's financial condition as of December 31, 1975, and in particular, *inter alia*, by failing to disclose:

(a) That Reserve had established grossly inadequate reserves for current and prior years' insurance claims and claims administration expenses;

(b) That Reserve was insolvent as of December 31, 1974;

(c) The true nature of the SCOR arrangement, the reasons for it, and its effect;

(d) The actions taken by ARC and the officers and directors subsequent to the reorganization in November, 1975, to continue to conceal Reserve's insolvency.

129. As a direct result of Andersen's breach of its written agreement, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor, and against Andersen in such amount as is determined to be due and owing.

COUNT XIII

Breach of Contract Claim Against Coopers

130. Plaintiff repeats and realleges the foregoing paragraphs 25 through 51, inclusive, paragraph 53, and paragraphs 55 through 61, inclusive, as paragraph 130 of this Count XIII of the Complaint.

131. Upon information and belief, Coopers entered into a written contract with Reserve, or in the alternative Coopers entered into a written contract with ARC for the benefit of Reserve, for the purpose of auditing Reserve and preparing the ARC consolidated financial statement which would accurately disclose Reserve's financial condition as of December 31, 1976. Coopers received and accepted valuable consideration for its services in this regard.

132. Coopers breached its written contract by failing to provide an audited consolidated financial statement which accurately reflected Reserve's financial condition as of December 31, 1976, and in particular, *inter alia,* by failing to disclose:

(a) That Reserve had established grossly inadequate reserves for current and prior years' insurance claims and claims administration expenses;

(b) That Reserve was insolvent as of December 31, 1974;

(c) The true nature of the SCOR arrangement, the reasons for it, and its effects;

(d) The actions taken by ARC and the officers and directors subsequent to the reorganization in November, 1975, to continue to conceal Reserve's insolvency.

133. As a direct result of Cooper's breaches of its written agreement, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor, and against Coopers in such amount as is determined to be due and owing.

COUNT XIV

Breach of Contract Claim Against Grant (Reserve 1976)

134. Plaintiff repeats and realleges the foregoing paragraphs 25 through 51, inclusive, and paragraph 54 through 61, inclusive, as paragraph 134 of this Count XIV of the Complaint.

135. Upon information and belief, Grant entered into a written contract with Reserve for the purpose of auditing Reserve and preparing an audited financial statement separate from the ARC consolidated financial statement which would accurately disclose Reserve's financial condition as of December 31, 1976. Grant received and accepted valuable consideration for its services in this regard.

136. Grant breached its written contract with Reserve by failing to provide Reserve with an audited financial statement which accurately reflected Reserve's financial condition as of December 31, 1976, and in particular, *inter alia*, by failing to disclose:

(a) That Reserve had established grossly inadequate reserves for current and prior years' insurance claims and claims administration expenses;

(b) That Reserve was insolvent as of December 31, 1974;

(c) The true nature of the SCOR arrangement, the reasons for it, and its effects;

(d) The actions taken by ARC and the officers and directors subsequent to the reorganization in November, 1975, to continue to conceal Reserve's insolvency.

137. As a direct result of Grant's breaches of its written agreement with Reserve, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor, and against Grant in such amount as is determined to be due and owing.

COUNT XV

Breach of Contract Claim Against Grant (1977)

138. Plaintiff repeats and realleges the foregoing paragraphs 25 through 51, inclusive, and paragraphs 54 through 61, inclusive, as paragraph 138 of this Count XV of the Complaint.

139. Upon information and belief, Grant entered into a written contract with Reserve, or in the alternative Grant entered into a written contract with ARC for the benefit of Reserve, for the purpose of auditing Reserve and preparing the ARC consolidated financial statement which would accurately disclose Reserve's financial condition as of December

31, 1977. Grant received and accepted consideration for its services in this regard.

140. Grant breached its written contract by failing to provide an audited consolidated financial statement which accurately reflected Reserve's financial statement as of December 31, 1977, and in particular, *inter alia,* by failing to disclose:

(a) That Reserve had established grossly inadequate reserves for current and prior years' insurance claims and claims administration expenses;

(b) That Reserve was insolvent as of December 31, 1974;

(c) The true nature of the SCOR arrangement, the reasons for it, and its effects;

(d) The actions taken by ARC and the officers and directors subsequent to the reorganization in November, 1975, to continue to conceal Reserve's insolvency.

141. As a direct result of Grant's breaches of its written agreement, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined as this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor, and against Grant in such amount as is determined to be due and owing.

COUNT XVI

Breach of Contract Claim Against Grant (Reserve 1977)

142. Plaintiff repeats and realleges the foregoing paragraphs 25 through 51, inclusive, and paragraphs 54 through 61, inclusive, as paragraph 142 of this Count XVI of the Complaint.

143. Upon information and belief, Grant entered into a written contract with Reserve for the purpose of auditing Reserve and preparing an audited financial statement separate from the ARC consolidated financial statement which would accurately disclose Reserve's financial condition as of December 31, 1977. Grant received and accepted valuable consideration for its services in this regard.

144. Grant breached its written contract with Reserve by failing to provide Reserve with an audited financial statement which accurately reflected Reserve's financial condition as of December 31, 1977, and in particular, *inter alia*, by failing to disclose:

(a) That Reserve had established grossly inadequate reserves for current and prior years' insurance claims and claims administration expenses;

(b) That Reserve was insolvent as of December 31, 1974;

(c) The true nature of the SCOR arrangement, the reasons for it, and its effects;

(d) The actions taken by ARC and the officers and directors subsequent to the reorganization in November, 1975, to continue to conceal reserve's [sic] insolvency.

145. As a direct result of Grant's breaches of its written agreement with Reserve, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, plaintiff prays that this court enter judgment in his favor, and against Grant in such amount as is determined to be due and owing.

COUNT XVII

Negligence Claim Against Andersen, Coopers and Grant

146. Plaintiff repeats and realleges the foregoing paragraphs 25 through 61, inclusive, as paragraph 146 of this Count XVII of the Complaint.

147. Andersen, Coopers and Grant were retained by Reserve, or in the alternative were retained by ARC for the benefit of Reserve, for the purpose of preparing audited financial statements which would accurately disclose the financial condition of Reserve during the periods covered by their respective engagements.

148. Andersen, Coopers and Grant each owed a duty to Reserve to perform their audit according to the standards, and with the degree of care, which generally prevailed in the account profession during the period covered by their respective engagements.

149. Andersen, Coopers and Grant each knew that, among others, Reserve, its policyholders, creditors and shareholders, and the Illinois Department would rely upon the information set forth in the financial statements, particularly for the purpose of receiving assurances regarding Reserve's solvency and its ability to continue to write insurance.

150. Andersen, Coopers and Grant breached their duty to Reserve by negligently preparing the aforesaid financial statements and negligently misrepresenting Reserve's financial condition in that, *inter alia*, they:

(a) Failed to disclose Reserve's insolvency, which insolvency had persisted since at least December 31, 1974;

(b) Failed to disclose that ARC and Reserve had not established adequate reserves for current and prior year's insurance claims and claims administration expenses;

(c) Failed to disclose management's conscious policy of delaying the payment of all claims, no matter how obvious their merit;

(d) Failed to disclose that the "pyramiding" of ARC's operating subsidiaries subsequent to the reorganization in November, 1975, had obscured Reserve's true financial condition;

(e) Failed to disclose the payment of excessive dividends by Reserve to ARC;

(f) Failed to disclose the true nature of the SCOR arrangement, the reasons for it, and its effects.

151. Reserve relied upon the financial statements prepared by Andersen, Coopers and Grant in continuing to write insurance after December 31, 1974. Furthermore, the Illinois Department relied upon the aforesaid financial statements in determining whether Reserve was financially stable enough to be allowed to continue to do business, pursuant to ch. 73, § 756.1, Ill. Rev. Stat.

152. Had Andersen, Coopers and Grant acted in conformance with their aforesaid duty of care, Reserve would not have, nor would it have been permitted, to write insurance after December 31, 1974, its assets would not have been dissipated and it would not have been caused to incur additional liabilities after that date.

153. As a direct and proximate result of the failure of Andersen, Coopers and Grant to exercise ordinary care in the discharge of their duties as outside auditors, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

154. At all relevant times herein Reserve exercised due care on its own part and was free from contributory negligence.

WHEREFORE, plaintiff prays that this court enter judgment in his favor, and against Andersen, Coopers and Grant, jointly and severally, in such amount as is determined to be due and owing.

COUNT XVIII

Fraudulent Misrepresentation Claim Against Andersen, Coopers And Grant—Compensatory And Punitive Damages

155. Plaintiff repeats and realleges the foregoing paragraphs 25 through 61, inclusive, as paragraph 155 of this Count XVIII of the Complaint.

156. Andersen, Coopers and Grant were retained by Reserve, or in the alternative were retained by ARC for the benefit of Reserve, for the purpose of preparing audited financial statements which would accurately disclose the financial condition of Reserve during the periods covered by their respective engagements.

157. Each of the financial statements prepared by Andersen, Coopers and Grant purported to depict accurately the financial condition of Reserve during the period identified therein. None of the financial statements were in fact accurate, because they failed to disclose, *inter alia*:

(a) Reserve's insolvency, which insolvency had persisted since at least December 31, 1974;

(b) That ARC and Reserve had not established adequate reserves for current and prior year's insurance claims and claims administration expenses;

(c) Management's conscious policy of delaying the payment of all claims, no matter how obvious their merit;

(d) The "pyramiding" of ARC's operating subsidiaries subsequent to the reorganization in November, 1975, which obscured Reserve's true financial condition;

(e) The payment of excessive dividends by Reserve to ARC;

(f) The true nature of the SCOR arrangement, the reasons for it, and its effects.

158. As a result of the above acts and omissions, each of the financial statements prepared by Andersen, Coopers and Grant materially misstated the true financial condition of Reserve.

159. Andersen, Coopers and Grant knew that the financial statements were false and inaccurate due to the omission of the matters set forth above.

160. Andersen, Coopers and Grant knew that Reserve would rely upon the financial statements prepared by them in determining whether or not to continue operating as an insurance company. They further knew that the statements would be delivered to the Illinois Department and that the Illinois Department would rely upon the statements in determining whether Reserve should be permitted to continue to write insurance, pursuant to ch. 73, § 756.1, Ill. Rev. Stat.

161. In spite of the knowledge of Andersen, Coopers and Grant that the financial statements were false, inaccurate and misleading, they nonetheless prepared and issued them for the purpose of concealing Reserve's insolvency so that Reserve could continue to write insurance.

162. Reserve did in fact rely upon the false financial statements in continuing to write insurance after December 31, 1974. Furthermore, the Illinois Department did in fact rely upon the aforesaid financial statements in determining whether Reserve was financially stable enough to be allowed to continue to do business, pursuant to ch. 73, § 756.1, Ill. Rev. Stat.

163. Because of the reliance of Reserve and the Illinois Department upon the false and misleading financial statements, Reserve continued to write insurance and was caused to incur additional liabilities notwithstanding that Reserve was at all relevant times insolvent.

164. Due to the fraudulent misrepresentations of Andersen, Coopers and Grant, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, plaintiff prays that this court enter judgment in his favor, and against Andersen, Coopers and Grant, jointly and severally, in such amount as is determined to be due and owning, and further that this court make an additional award of punitive damages in the amount of $200,000,000, plus costs.

COUNT XIX

Breach of Fiduciary Duty Claim Against Andersen, Coopers And Grant

165. Plaintiff repeats and realleges the foregoing paragraphs 25 through 61, inclusive, as paragraph 165 of this Count XIX of the Complaint.

166. Andersen, Coopers and Grant owed a fiduciary duty to Reserve, as outside auditors of Reserve, to administer their audits of Reserve accurately and for the common benefits of Reserve, its policyholders, creditors and shareholders, and to exercise their best care, skill and judgment in conducting their audits of Reserve.

167. Andersen, Coopers and Grant failed to discharge their fiduciary duty to Reserve in that they:

(a) Failed to reveal that the officers and directors failed to keep correct and accurate books and records of accounts for Reserve in violation of ch. 32, § 157.45, Ill. Rev. Stat. and ch. 73, § 745, Ill. Rev. Stat.;

(b) Failed to reveal that the officers and directors instituted a conscious policy of delaying the payment of all claims, no matter how obvious their merit, in violation of ch. 73, §§ 766.5-767, Ill. Rev. Stat.;

(c) Knowingly understated the reserves that were necessary to satisfy claims and claims administration expenses in ARC's consolidated financial statements for the years ending December 31, 1974, 1975, 1976 and 1977;

(d) Failed to disclose the nature, reasons and effect of the SCOR arrangement in those financial statements;

(e) Reflected Reserve's cessions of insurance in its NAIC Convention Statements for the years ending December 31, 1975, 1976 and 1977, even though such cessions should not have been reflected due to the potential effect on surplus if those reinsurance agreements were cancelled;

(f) Knowingly misstated the effect of such cancellation in the reinsurance interrogatories contained in those Convention Statements;

168. Andersen, Coopers and Grant also breached their fiduciary duty to Reserve in that they took no steps to prevent Reserve from continuing to write insurance, even though they knew Reserve was insolvent, in violation of ch. 73, § 756.1, Ill. Rev. Stat.; and they took no steps to prevent the transfer by ARC of more than $3,000,000 of Reserve's income through SCOR to GRC, which, in turn, transferred that income to ARC in the form of dividends or loans, even

though they knew that such acts were in contravention of the consent agreement with the Illinois Department and ch. 32, § 157.42.1, Ill. Rev. Stat.

169. As direct result of the breaches of fiduciary duties owed by Andersen, Coopers and Grant to Reserve, Reserve continued to write insurance and was caused to incur additional liabilities, and Reserve's assets were dissipated notwithstanding that Reserve was at all relevant times insolvent, and Reserve suffered damages in the amount said assets were dissipated and the amount of said additional liabilities, the exact amount of which cannot be determined at this time, but which are believed to be in excess of $100,000,000.

WHEREFORE, plaintiff prays that this court enter judgment in his favor, and against Andersen, Coopers and Grant, jointly and severally, in such amount as is determined to be due and owing.

COUNT XX

Willful, Wanton And Intentional Breach Of Fiduciary Duty Claim Against Andersen, Coopers and Grant—Punitive Damages

170. Plaintiff repeats and realleges the foregoing paragraphs 165 through 169, inclusive, as paragraph 170 of this Count XX of the Complaint.

171. Each of the foregoing acts or omissions of Andersen, Coopers and Grant constituting a breach of their fiduciary duties was willful, wanton and intentional and was made with total disregard for its consequences, the plaintiff is entitled to an additional award of punitive damages in the amount of $200,000,000.

WHEREFORE, Plaintiff prays that this court enter judgment in his favor, and against Andersen, Coopers and Grant, jointly and severally, in the amount of $200,000,000, plus costs.

PHILIP R. O'CONNOR,
Director of Insurance of the
State of Illinois and Liquidator
of Reserve Insurance Company

By_____
One Of His Attorneys

The Plaintiff Demands a Jury Trial.

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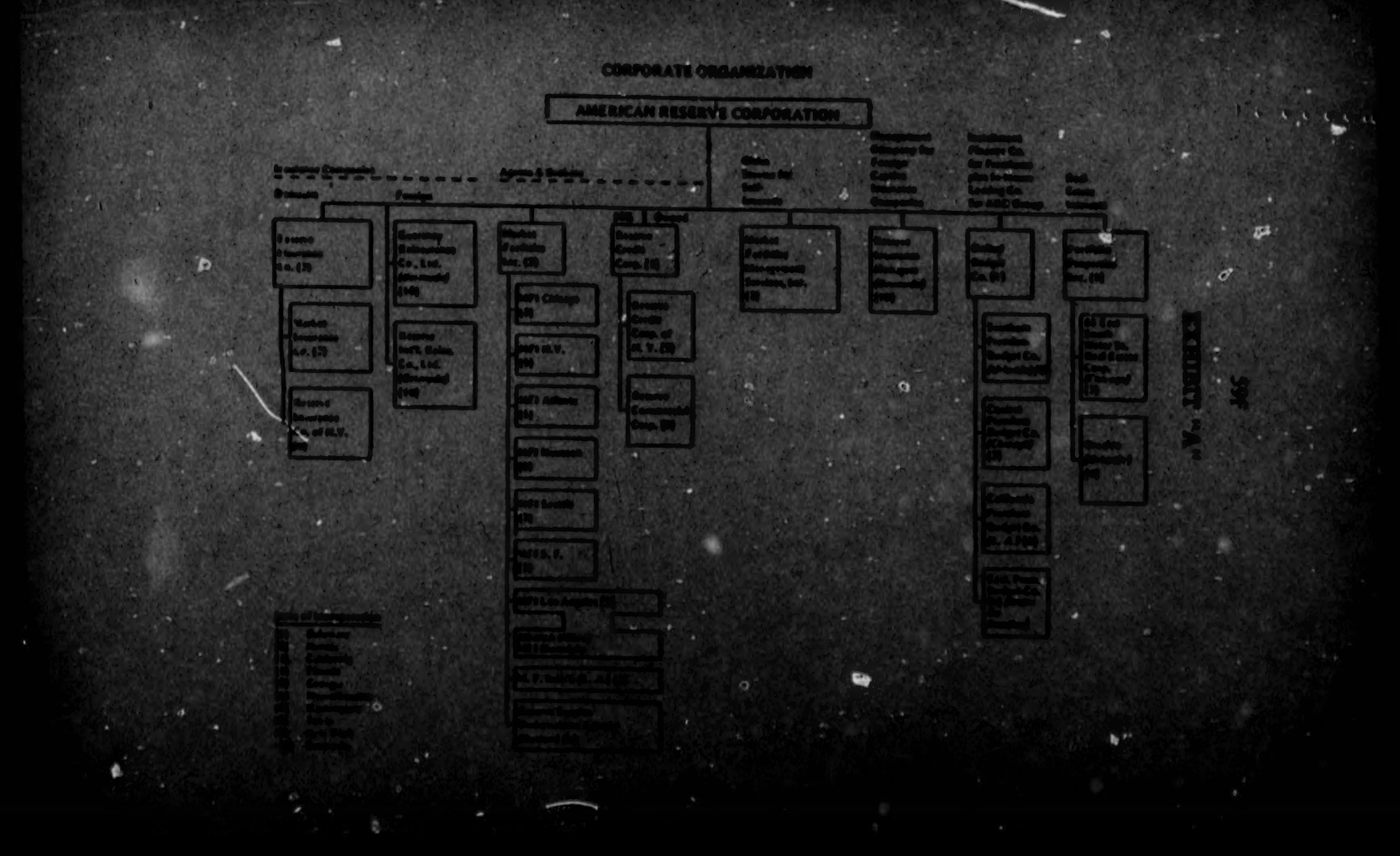
CORPORATE ORGANIZATION
AMERICAN RESERVE CORPORATION

EXHIBIT "B"

STATE OF ILLINOIS
DEPARTMENT OF INSURANCE

STIPULATION AND CONSENT ORDER

WHEREAS, Reserve Insurance Company is an insurance company domiciled in the State of Illinois and authorized to write the kinds of business set forth in Clauses 2 and 3 of Section 4 of the Illinois Insurance Code (Ch. 73, Para. 610, Ill. Rev. Stat.), and is a wholly-owned subsidiary of American Reserve Corporation (hereinafter ARC), and

WHEREAS, the Reserve Insurance Company has filed an annual statement for the year ending December 1974 which reflected an excessive ratio of premium volume to policyholders' surplus, and

WHEREAS, the Reserve Insurance Company and the Director of Insurance, State of Illinois, have met and discussed all aspects of the above described excess ratio;

NOW, THEREFORE, Reserve Insurance Company by Wallace J. Stenhouse, Jr., its Chairman of the Board, and the Director of Insurance, State of Illinois, hereby agree and stipulate that:

1. The ratio of premium volume to policyholders' surplus contained in the annual statement requires affirmative action immediately for correction of the circumstances, and

2. Reserve Insurance Company accepts the need for affirmative action immediately and agrees to the following Order by the Director of Insurance in recognition of such need.

IT IS HEREBY ORDERED by the undersigned, Robert B. Wilcox, Director of Insurance, State of Illinois, pursuant to

Sections 401, 402, and 403 of the Illinois Insurance Code that Reserve Insurance Company, hereinafter the Company, take the following action:

A. The Company shall write no more than $50 million of premium, net of reinsurance, during the calendar year 1975, provided, however, that in no event shall such premiums exceed four times the amount of policyholders' surplus as of December 31, 1975.

B. The Company shall supply quarterly financial reports including all investment activity and transactions in a format designated by the Director no later than 60 days following March 31, June 30, and September 30.

C. The Company shall not exchange any asset(s) of any kind or type with ARC; loan cash, securities of any kind or paper of any kind to ARC; sell securities of any kind or paper of any kind to ARC; or buy securities of any kind or paper of any kind from ARC without prior approval of the Director of Insurance. The failure of the Director of Insurance to act within 30 days after the submission of a written request for approval for such exchange, or loan, or purchase, or sale shall constitute approval. As used in this Section, ARC shall mean American Reserve Corporation or any of its subsidiaries or affiliates.

D. No asset(s) belonging to the Company shall be loaned to or pledged to or on behalf of any individual without the prior approval of the Director of Insurance.

E. The Company shall submit to the Director of Insurance for his approval all reinsurance agreements, whether cessions or assumptions, which cede or assume an anticipated annual premium volume of $2 million or more. The failure of the Director to act upon such a reinsurance agreement witnin 20 days of submission shall constitute his approval.

F. Until such time that the Company has a positive unassigned funds account as reported in the last annual statement and premium to surplus ratio of less than 4 to 1 for the prior 12 months, the Company is prohibited from the payment of cash dividends to subsidiaries without the prior approval of the Director of Insurance.

G. The Company shall obtain from their Certified Public Accountant a certification of the balance sheet and income statement as contained in the 1974 annual statement as filed with the Director of Insurance.

H. The Company shall at all times possess marketable securities of the type and value described in Section 155.10 of the Illinois Insurance Code in amount equal to no less than 100% of the Company's reserves for losses and loss adjustment expenses, plus 50% of the reserves for unearned premiums. The reserves shall be calculated quarterly as follows:

(a) The unearned premium reserve as contained in the last quarterly financial report as filed with the Director of Insurance.

(b) The loss and loss expense reserves as of the last day of the first preceding calendar year adjusted by the difference between losses paid since that date on other than the current accident year and loss reserves for the current accident year plus estimated loss expense reserves attributed to that difference.

Further the Company shall cause an independent certified public accountant to submit a quarterly report to the Director of Insurance setting forth the type, admitted value, ownership and physical location of the marketable securities required by this Section.

I. Nothing herein contained shall in any way limit any power or authority given the Director of Insurance

by the Illinois Insurance Code, and the terms and conditions set forth by this Order shall expire on the 30th day of June, 1976.

Dated this 15th day of April, 1975

/s/ ROBERT B. WILCOX
Robert B. Wilcox
Director of Insurance

On behalf of Reserve Insurance Company consented to by Wallace Stenhouse who has been given authority by the Board of Directors to enter into such agreements and consent orders.

/s/ WALLACE STENHOUSE
Reserve Insurance Company

/s/ MICHAEL L. MEYER
Attest: Secretary

EXHIBIT "D"
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
March 12, 1979

No. 804313

In the Matter of
AMERICAN RESERVE CORPORATION
55 East Monroe Street
Chicago, Illinois 60603

Order Instituting Proceedings Pursuant to Section 15(c)(4) of the Securities Exchange Act of 1934 and Findings, Opinion and Order of the Commission

---

The Commission deems it appropriate in the public interest that proceedings be instituted with respect to American Reserve Corporation ("ARC") pursuant to the provisions of Section 15(c)(4) of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether certain filings by ARC failed to comply in any material respect with provisions of Section 13(a) of the Exchange Act and Rules and Regulations promulgated thereunder concerning the reporting of a series of reinsurance agreements between certain wholly-owned subsidiaries of ARC and a European reinsurance company.

Simultaneously with the institution of these proceedings, ARC has submitted an offer of settlement for the purpose of disposing of the issues raised in these proceedings. Under the terms of its offer of settlement, ARC, solely for the purpose of these proceedings, and, without admitting or denying the Commission's Findings set forth herein, consents to the issuance of this Order.

The Commission has determined that it is appropriate and in the public interest to accept the offer of settlement of ARC and, accordingly, is issuing this Order.

I

DESCRIPTION OF ARC AND SUBSIDIARIES

ARC is a holding company whose subsidiaries are engaged primarily in the property and casualty insurance business. ARC's principal areas of concentration are in "specialized" coverages, including high-risk automobile policies; insurance for motorcyclists, mobile-home owners and other recreational vehicles; and coverage for commercial enterprises such as apartment-houses, beauty and pet care salons and other small businesses. A small portion of ARC's business is in life insurance and annuities. ARC's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act, and ARC has, during all times here relevant, filed periodic reports with the Commission pursuant to Section 13 of the Exchange Act.

Two of ARC's major operating subsidiaries are Reserve Insurance Company ("Reserve") and Market Insurance Company ("Market"). Both Reserve and Market are Illinois insurance companies and are subject to regulation by the Illinois Department of Insurance. Another ARC subsidiary is Guaranty Reinsurance Company Ltd. ("GRC"), a Bermuda insurance company.

II

FINDINGS

1. In 1974, as a result of prior insurance losses, Reserve and Market were experiencing a marked reduction in their ability to write and retain new insurance. Unless Reserve and Market took action to increase their financial capacity or decrease their exposure to risk, Reserve and Market might not have been able to preserve their existing marketing

structure, particularly their ongoing relationship with independent insurance agents and brokers. In short, ARC faced the prospect of having to cut back the amount of new insurance business written by its subsidiaries and consequent disruption of its relationship with its marketing force. In order to remedy these problems, in December 1974, Reserve, Market, GRC and ARC entered into a reinsurance arrangement with a major European reinsurance company ("Reinsurer"), as a replacement for a reinsurance arrangement that had been in effect among Reserve, Market and GRC. Reserve and Market reinsured a portion of their insurance business with Reinsurer which in turn re-reinsured 90% of that same business with GRC. ARC assumed the role of guarantor of the performance of its subsidiaries, which, in effect, required that ARC take on a contingent liability of indeterminate magnitude. This arrangement continued in effect until September 30, 1978, and included the following elements:

A) **Cession Agreement Among Reserve, Market and Reinsurer.** Reserve and Market "ceded" (reinsured) with Reinsurer 90% of a block of business on an unearned premium basis. The aggregate amounts reinsured by Reserve and Market under this arrangement, the aggregate amounts of Reserve's and Market's total premiums written and ARC's total premiums written for each year from the inception of the arrangement through December 31, 1977, are as follows:

	Reserve and Market Total Premiums	Reserve and Market Amounts Reinsured	ARC (Consolidated) Total Premiums Written
1974	$136.6 million	$17.8 million	$135.7 million
1975	$116.8 million	$25.6 million	$123.9 million
1976	$136.8 million	$34.2 million	$165.4 million
1977	$135.5 million	$50.2 million	$164.0 million

During 1978, prior to the September 30 termination of the arrangement, Reserve and Market reinsured unearned premiums aggregating $25.2 million. In connection with the termination of the arrangement, $17.3 million of unearned premiums were retroceded to Reserve and Market.

B) **Retrocession Agreement Between Reinsurer and GRC.** Reinsurer agreed to "retrocede" (re-reinsure) to GRC, a company whose net worth fluctuated between $1.8 million and $2.9 million during the time the arrangement was in effect, 90% of the premiums ceded to Reinsurer under the arrangement with Reserve and Market, as and when the premiums were earned. Reinsurer retained the remaining 10% of the earned premiums. The net premiums retained by Reinsurer, the earned premiums retroceded to GRC, and ARC's total earned premiums for each year from the inception of the reinsurance arrangement through December 31, 1977, are as follows:

	Net Premiums Retained by Reinsurer	Earned Premiums Retroceded to GRC	ARC (Consolidated) Total Earned Premiums
1974	$15.8 million	$ 2.0 million	$100.8 million
1975	$ 0.8 million	$24.8 million	$ 98.5 million
1976	$ 7.7 million	$26.5 million	$129.8 million
1977	$ 7.6 million	$42.6 million	$132.5 million

During 1978, reflecting the termination of the arrangement in that year, the Reinsurer retained $2.9 million of earned premiums and retroceded to GRC $26.3 million of earned premiums.

C) **ARC Guaranty of Performance of Subsidiaries.** Reinsurer required ARC to guarantee the performance of its subsidiaries under this reinsurance arrangement, including GRC's performance under the Retrocession Agreement between Reinsurer and GRC.

2. Under the terms of the arrangement, Reinsurer has been entitled to receive various elements of compensation. The following table summarizes the aggregate compensation paid to Reinsurer by the ARC group from 1974 through September 30, 1978, exclusive of Reinsurer's expenses and

underwriting earnings on business ceded to Reinsurer and not retroceded to GRC:

	Amount Paid Reinsurer by ARC
1974	$ 54,052
1975	597,861
1976	601,773
1977	899,614
1978	598,306

3. In late 1974, Reserve and Market obtained the approval of the Director of the Illinois Department of Insurance to enter into the above cession to Reinsurer. Since ARC believed that the elements of the arrangement not involving Reserve and Market did not require approval by the Illinois Department of Insurance at the time of obtaining that Department's approval of the cession, ARC did not inform that Department of the existence of the retrocession to GRC or of ARC's guarantee of its subsidiaries' performance under the arrangement.

4. ARC filed with the Commission Annual Reports on Form 10-K for its fiscal years ended December 31, 1974, through December 31, 1977, which failed in material respects to disclose the arrangement with Reinsurer and to make specific reference to its potential impact on ARC.

III

ORDER

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the offer of settlement of ARC and, accordingly, IT IS HEREBY ORDERED that such proceedings be and are hereby instituted by the issuance of this Order; and that ARC promptly file with the Commission a Report on Form 8 amending its reports on Form 10-K for the years 1974, 1975, 1976 and 1977.

By the issuance of this Order, and subject to ARC's compliance with the terms of this Order, this proceeding is concluded.

By the Commission.

George A. Fitzsimmons
Secretary

Nos. 83-539 and 83-548

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

ARTHUR ANDERSEN & CO., et al.,

Petitioners,

v.

JAMES A. SCHACHT, the Acting Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company,

Respondent.

ISADORE BROWN, et al.,

Petitioners,

v.

JAMES A. SCHACHT, the Acting Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company,

Respondent.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

Each petition's statement of "Questions Presented" violates the dictates of Supreme Court Rule 21.1(a) that questions should be expressed in the terms and circumstances of the case and should not be argumentative. Every question petitioners present is dependent upon mischaracterizations of the court of appeals opinion and the allegations of the complaint. Furthermore, the accountant and reinsurance petitioners have hidden within the folds of their first question a substantive argument not presented to the court of appeals: that is, that RICO is not violated unless the perpetrator gains an "economic advantage" by his conduct. The assertion of this argument offends the Court's policy of not considering issues that were not briefed or argued below.

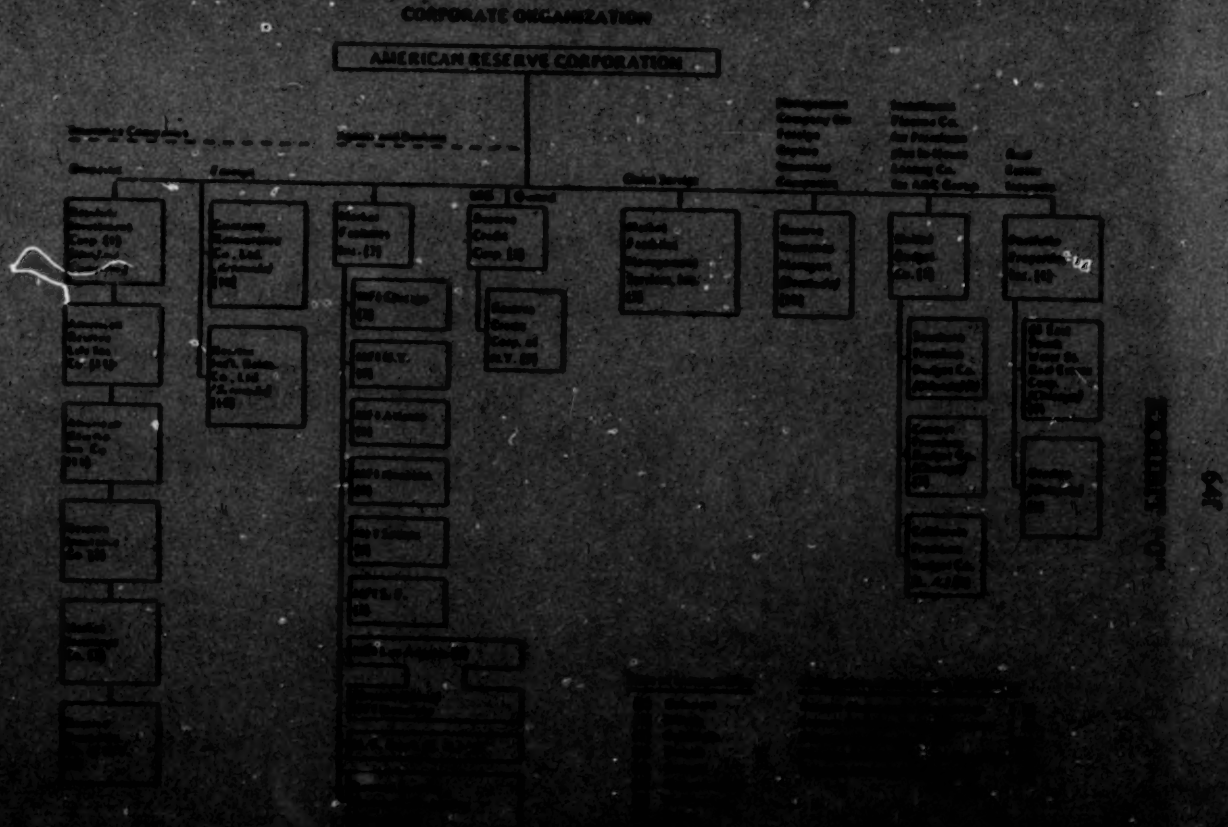
CORPORATE ORGANIZATION
AMERICAN RESERVE CORPORATION

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	iii
OPINIONS BELOW	1
STATEMENT	2
The Petitioners' Victimization Of Reserve Insurance Company	2
REASONS FOR DENYING THE WRIT:	
I.	
The Central Question Posed By The Petitioners Mischaracterizes RICO's Statutory Scheme And Is Not Presented By The Complaint	6
II.	
The Court Of Appeals' Refusal To Engraft Court-Made Limitations On RICO Is Consistent With The Statutory Language And Decisions Of The Other Circuits	11
III.	
Reserve, Victimized By The Petitioners, Is Not And Should Not Be Estopped From Pursuing Its Remedies	15
IV.	
There Is No Conflict Between The Seventh And Eighth Circuits: Auditors And Other So-Called "Outsiders" Can Be Defendants In §1962(c) Actions	17
CONCLUSION	19

TABLE OF AUTHORITIES

Cases

Adickes v. Kress & Co., 398 U.S. 144 (1970) .. 11
Associated General Contractors of California, Inc. v. California State Council of Carpenters, 103 S.Ct. 897 (1983) 17
Bennett v. Berg, 685 F.2d 1053 (8th Cir. 1982), *adopted en banc*, 710 F.2d 1361 (8th Cir. 1983) 6, 13, 14, 18
Christianburg Garment Co. v. EEOC, 434 U.S. 412 (1978) 10
Kleiner v. First National Bank of Atlanta, 526 F.Supp. 1019 (N.D. Ga. 1981) 14
Lawn v. United States, 355 U.S. 339 (1958) ... 11
Morosani v. First National Bank of Atlanta, 703 F.2d 1220 (11th Cir. 1983) 13
Moss v. Morgan Stanley, No. 83-7110 (2d Cir. Sept. 9, 1983) 10, 13
People of the State of Illinois v. Reserve Insurance Co., No. 79 CH 2828, Circuit Court of Cook County, Ill. (May 29, 1979) 2
Reiter v. Sonotone Corp., 442 U.S. 330 (1979) . 9
United States v. Turkette, 452 U.S. 576 (1981) 11, 12, 14
USACO Coal Co. v. Carbomin Energy, Inc., 689 F.2d 94 (6th Cir. 1982) 13

Statutes

Ill. Rev. Stat. chap. 73, para. 756.1 3
Ill. Rev. Stat. chap. 73, para. 799 2
Ill. Rev. Stat. chap. 73, para. 817 17

18 U.S.C. §1962 ..... *passim*
18 U.S.C. §1964 ..... *passim*
Pub. L. No. 91-452, Title IX, §904, 84 Stat. 941 (1970) 9

Other Authorities

Rule 9(b) Fed.R.Civ.P. 2, 9, 10
Rule 12 Fed.R.Civ.P. 9, 10

In The

Supreme Court of the United States

October Term, 1983

ARTHUR ANDERSEN & CO., et al.,

Petitioners,

v.

JAMES A. SCHACHT, the Acting Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company,

Respondent.

ISADORE BROWN, et al.,

Petitioners,

v.

JAMES A. SCHACHT, the Acting Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company,

Respondent.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

OPINIONS BELOW

Each petitions' description of the opinions below omits to state that the Seventh Circuit opinion, for which this writ of certiorari is sought, affirmed the district court's denial of the petitioners' motions to dismiss the Director's complaint. The district court also held that the alle-

gations of the complaint were sufficiently specific to satisfy Rule 9(b) of the Federal Rules of Civil Procedure. No appeal was taken from this holding.

STATEMENT

The plaintiff in this cause is the Director of Insurance of the State of Illinois who, in accordance with the Illinois Insurance Code, Ill.Rev.Stat. chap. 73, para. 799 *et seq.*, was appointed liquidator of Reserve Insurance Company when it was declared insolvent, was vested with title to Reserve's causes of action, and was directed "to take such action as the nature of this cause and the interests of the policyholders, creditors, stockholders or the public may require. . . ."*

The Petitioners' Victimization Of Reserve Insurance Company

The petitioners' descriptions of the allegations in the Director's complaint—which they say is about "underestimation" of an insurance company's reserves (Acct. at 4, Offs. at 3)**—are outright misstatements. The complaint charges each petitioner with knowingly assuming a necessary role in an ongoing scheme fraudulently to continue operating an Illinois insurance company long after it had reached insolvency, a scheme which misled

* *People of the State of Illinois v. Reserve Insurance Co.*, No. 79 CH 2828, Circuit Court, Cook Cty., Ill. (May 29, 1979).

** "Acct." refers to the petition filed jointly by the accountant and reinsurance defendants. "Offs." refers to the petition filed jointly by the officer and director defendants.

the state insurance regulators, was fatal to the company, and left thousands of Illinois citizens holding worthless insurance policies.

Reserve, an Illinois domiciled company, was the wholly owned subsidiary of American Reserve Corporation ("ARC"), a publicly held insurance holding company. ARC controlled every detail of Reserve's corporate life. ARC's officers were Reserve's officers (¶¶11, 14, 16-18);* its directors were Reserve's directors (¶¶5-10, 12, 13, 18); and its auditors were Reserve's auditors (¶¶21-23).

Reserve had traditionally written high-risk policies. Acting with the full knowledge of its auditors at the time, petitioner Arthur Andersen and Company, from at least the late 1960's Reserve's managers had consistently underreserved for claims under these policies (¶¶26, 27). Eventually, the dangerous combination of writing risky business without adequately reserving for it began to result in substantial losses. By 1974, at the latest, Reserve was insolvent (¶29). Because it is illegal in Illinois for an insolvent company to write insurance, Ill.Rev.Stat. chap. 73, para. 756.1 (¶41), it was at this point that the petitioners formulated and implemented a scheme to conceal Reserve's insolvency. The purpose of the scheme was to prolong Reserve's existence so that it could continue to generate income for the petitioners.

One aspect of the scheme was to cause Reserve to enter into a financing arrangement, which masqueraded as a legitimate reinsurance deal, with petitioner Societe Commerciale De Reassurance ("SCOR") (¶30). At the time the arrangement was entered SCOR was aware that Reserve was insolvent and knew that the arrangement concealed

* Paragraph references are to the Director's complaint, reprinted at 1f-70f of the Petitioners' Joint Appendix.

the insolvency. Still, SCOR willingly joined in and advanced the petitioners' purposes (¶37).

Under the terms of the arrangement Reserve ceded its least risky and most profitable business to SCOR. SCOR retroceded most of the Reserve business to non-petitioning defendant Guaranty Reinsurance Company ("GRC"), an unregulated off-shore company owned by ARC. ARC guaranteed GRC's performance to SCOR (¶30). The upshot of these transactions was that Reserve transferred away its most profitable business to GRC (¶¶30-32, 42), which sent its resulting profits upstream to its parent, ARC (¶¶30-32, 42); SCOR paid "commissions" to Reserve helping it to appear solvent (¶33); and SCOR was reimbursed for its expenses and received an additional $2.5 million from ARC (¶35). In short, this deal made money for every party involved except Reserve.

The SCOR arrangement was formalized in December, 1974. ARC's principals disclosed Reserve's cession to SCOR to the Illinois Department of Insurance, as required by law, but SCOR's retrocession to GRC, the ARC guaranty of GRC's performance and the so-called "commission payments" were intentionally not disclosed (¶31). In Spring of 1975, the Department of Insurance, concerned about Reserve's financial condition, called in ARC's principals and demanded that they enter a consent decree aimed at reducing new business written by Reserve and protecting Reserve's assets from ARC and its other subsidiaries (¶38). Even as ARC's principals were negotiating the terms of the decree with the Department they concealed the retrocession and guaranty aspects of the SCOR arrangement, knowing that these aspects would enable covert circumvention of the decree's restrictions. Further, a few months after the decree was entered, ARC reorganized its subsidiaries in a manner which permitted ARC's management secretly to direct Reserve business to ARC

subsidiaries which were beyond the reach of Illinois regulators and the consent decree (¶¶45-48).

The core element of the petitioners' scheme was Reserve's and ARC's financial statements, prepared for submission to state and federal regulators. Each year from at least 1968, these statements hid Reserve's true disastrous condition by understating the company's liabilities (¶¶26, 29, 50, 53, 54, 56). This was done knowingly and intentionally by ARC's principals and the auditors they engaged. Documents in the record before the Seventh Circuit indicate that in 1975 an Andersen partner had concluded that Reserve was $10-20 million underreserved and considered the company insolvent; in 1976, petitioner Coopers & Lybrand, ARC's new auditors, believed Reserve was $23 million underreserved; in 1977, petitioner Alexander Grant and Co., hired by ARC to replace Coopers, determined that in fact 1976 loss reserves had been understated by $22 million. Nevertheless, in 1975, 1976 and 1977, the auditors issued opinions that were unqualified as to loss reserves.

By 1979, the petitioners' deceptive practices could no longer conceal Reserve's insolvency (¶61). That year the Securities and Exchange Commission issued a report of an investigation it had conducted focusing on the treatment of the SCOR arrangement on ARC's financial statements (¶¶58-60). Soon after, Reserve was placed in liquidation, and ARC filed a plan for reorganization in the United States Bankruptcy Court for the Northern District of Illinois. *In re American Reserve Corporation*, 80 B 04786 (N.D. Ill., filed April 21, 1980). Subsequently, an Examiner appointed by the bankruptcy court concluded that ARC's financial statements through the 1970's had been grossly misleading, and that ARC's principals and auditors had probably known they were misleading. On the heels of the Examiner's Report, ARC's Chapter 11 proceeding was voluntarily converted to a Chapter 7 liquidation.

REASONS FOR DENYING THE WRIT

I.

THE CENTRAL QUESTION POSED BY THE PETITIONERS MISCHARACTERIZES RICO'S STATUTORY SCHEME AND IS NOT PRESENTED BY THE COMPLAINT.

Petitioners' central question for review is whether common law fraud accompanied by two mailings will alone sustain a RICO treble damage action (Acct. at 1, Offs. at i). To the extent that this question is intended simply to pose an abstract question about RICO, the Seventh Circuit dealt with it directly and summarily: "[N]either common law fraud nor securities law violations will, by themselves, be automatically eligible for redress through a civil RICO action; there is the additional requirement under §1964(c) [sic, §1962(c)], discussed *infra*, that an interstate enterprise be conducted 'through' a pattern of such activity" (App. at 24a).* The Eighth Circuit has given a nearly identical response to the same question:

> "In oral argument, the view was expressed that if we recognized appellants' claim as a RICO action, any scheme to defraud executed through two mailings would create a civil RICO claim. This misstates the elements of a RICO offense. Under the facial terms of section 1962, a RICO claim can only be stated where the scheme to defraud involves an enterprise, and where the enterprise is one which 'is engaged in, or the activities of which affect' interstate commerce." *Bennett v. Berg*, 685 F.2d 1053, 1064 n. 17 (8th Cir. 1982), *adopted en banc*, 710 F.2d 1361 (8th Cir. 1983).

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* "App." references are to the Seventh Circuit opinions, reprinted at 1a-37a, 1b-2b of the Petitioners' Joint Appendix.

To the extent the petitioners insinuate that their question relates to the allegations in the Director's complaint, this constitutes their third attempt to mislead a court into believing that the Director's complaint is about nothing more than a common law fraud involving use of the mails. Neither the district court nor the court of appeals was deceived by the petitioners' rhetoric and this Court should not be either.

This case is about each named petitioner, knowing Reserve to be insolvent, lending individual and varied expertise to the operation of ARC through an ongoing course of misconduct designed to cover up Reserve's insolvency. The misconduct included deliberate overstatement of reserves and falsification of financial statements, fake reinsurance, illegal dividends and systematic looting of Reserve's most profitable business all to the detriment of Reserve, its policyholders and creditors. As the district court and the court of appeals recognized, this is the stuff of which civil RICO is made.

RICO's private civil remedies, set out in 18 U.S.C. §1964(c), are available to "any person injured in his business or property by reason of" a violation of 18 U.S.C. §1962(a), (b) or (c). Section 1962(c), emphasized here, in turn, is violated when a "person" (the defendant) participates in conducting the affairs of an "enterprise" through a "pattern of racketeering activity." The gist of the Director's assertions is that the petitioners associated with ARC, the central enterprise involved, and conducted ARC's affairs through a "pattern of racketeering activity," i.e., the scheme to defraud, outlined above, in furtherance of which scheme the mails were used. Reserve was injured by reason of the full range of this conduct which artifically prolonged its existence and deepened its insolvency (*See* App. at 16a).

After scrutinizing the allegations of the complaint the Seventh Circuit concluded that they satisfied all the essential elements of RICO: that the petitioners' alleged conduct was precisely the type explicitly proscribed by §1962(c); and that Reserve as a victim of such conduct was a "person" within the meaning of §1964(c) and therefore had standing to bring the action. The court stated:

> "[T]he whole thrust of the Director's complaint is that Reserve was a victim of the dishonest *operation* of *ARC* through a pattern of sham reinsurance, falsification of financial statements, and fraudulent dealings with state insurance regulators which allowed ARC to prolong Reserve's life beyond insolvency and thus exacerbate its financial woes." App. at 31a; emphasis in original.

The court also concluded that it was this RICO-proscribed conduct that caused Reserve's injury: "Indeed, it is ARC's operation in such manner as to artificially prolong the operation of Reserve, not the mail fraud itself, which is separately underscored by the Director as the gravamen of the complaint" (App. at 18a). Therefore, contrary to the petitioners' deceptive assertion, repeated throughout the petitions, that the Seventh Circuit opinion "invites a private treble damage suit for any injury flowing solely from the predicate acts" (Acct. at 11, and also at 7, 8, 12, 16), the court of appeals analysis demands "a causal nexus between RICO-proscribed conduct and . . . damage" (App. at 32a), a nexus the court found to be alleged within the facts of the Director's complaint. In short, if this Court were to grant certiorari, it would *not* have before it for review a complaint based upon injuries resulting from mismanagement, securities laws violations or common law fraud; it would have a complaint for injuries resulting from an alleged five year course of deliberate criminal conduct proscribed by §1962(c).

Unable effectively to dispute the sufficiency of the charges of this complaint, the petitioners assert that the Seventh Circuit opinion will open litigation floodgates to *other* RICO actions that they contend should be confined to state court litigation. This argument, however, only overstates the obvious: any new statutory remedy will have an impact on the number of cases filed in federal court. The court of appeals recognized this but concluded: "Congress, as RICO's legislative history indicates, was alerted to the far-reaching implications of its enactment" (App. 36a). Indeed, Congress specifically directed that RICO "shall be liberally construed to effect its remedial purposes." Pub. L. No. 91-452, Title IX, §904, 84 Stat. 941 (1970). As this Court has commented with regard to civil antitrust suits: "To be sure these private suits impose a heavy litigation burden on the federal courts: it is the clear responsibility of Congress to provide the judicial resources necessary to execute its mandate." *Reiter v. Sonotone Corp.*, 442 U.S. 330, 344 (1979).

Stripped of feigned solicitude for federal court dockets, the thrust of the petitioners' floodgate argument is that RICO, as enacted by Congress and as applied by the Seventh Circuit, renders ordinary business persons vulnerable to treble damage actions whereas before they had only to defend themselves in state court. But petitioners and other business persons are not without tools for defending against unfounded RICO claims. For example, under Rule 9(b) of the Federal Rules of Civil Procedure *any* fraud, including mail fraud, must be pleaded with particularity.* Combining this Rule with Fed.R.

* As pointed out at p. 1 *supra*, in the district court petitioners made unsuccessful Rule 9(b) motions from which they took no appeal. The district judge's opinion regarding the sufficiency of the Director's fraud allegations is reprinted at App. at 4c.

Civ.P. 12, any RICO complaint is subject to motions to dismiss for failure to allege the elements of a §1962 violation. For example, in the leading Second Circuit civil RICO opinion, *Moss v. Morgan Stanley*, No. 83-7110 (2d Cir. Sept. 9, 1983), the court of appeals chided the district court for imposing artificial limitations on the scope of RICO, *see* p. 13 *infra*, but nevertheless upheld the dismissal of a RICO complaint that failed to state securities laws violations, the predicate acts upon which the RICO claim had been based.

Likewise, discovery rules and summary judgment procedures can facilitate expeditious resolution of baseless claims, RICO or otherwise. Invoking these procedures, along with the possible threat of the award of attorney's fees to RICO defendants joined in bad faith, *cf.*, *Christianburg Garment Co. v. EEOC*, 434 U.S. 412 (1978), is the proper method for protecting against abusive resort to civil RICO.

In sum, the petitioners ask the Court to grant certiorari to review questions not presented by the record. The district court below denied the petitioners' Rule 9(b) motions, and the Seventh Circuit, affirming the denial of the motions to dismiss, closely examined the Director's complaint to assure that all the essential elements of a RICO claim were pleaded. Given the facial sufficiency of this complaint, the petitioners' persistent quest to find some court that will dismiss it seeks more than merely a judicial construction of RICO; it seeks a judicial repeal of the statute. For the reasons set forth above, the petitions should be denied.

II.

THE COURT OF APPEALS' REFUSAL TO ENGRAFT COURT-MADE LIMITATIONS ON RICO IS CONSISTENT WITH THE STATUTORY LANGUAGE AND DECISIONS OF THE OTHER CIRCUITS.

Throughout these proceedings the petitioners have unsuccessfully urged that some standing limitation be judicially devised and engrafted upon §1964(c) in order to preclude most victims of business-related RICO violations from bringing suit. In seeking certiorari the petitioners shift their emphasis from §1964(c) and RICO victims, and now assert that courts should devise a limitation on §1962(c) and the type of conduct it proscribes. They offer here for the first time the theory that §1962(c) is limited to conduct that creates an economic advantage for the perpetrator (Acct. at 14-17). However, this theory was not briefed or argued in the court below, and as the Court has often admonished, such a newly-presented legal argument is not an appropriate basis for granting certiorari. *Adickes v. Kress & Co.*, 398 U.S. 144, 147 n. 2 (1970); *Lawn v. United States*, 355 U.S. 339, 362-3 n. 16 (1958).

The impropriety of asserting the economic advantage theory aside, it is refuted both by the language of §1962(c) which contains no reference, explicit or implied, to economic advantage; as well as by this Court's reasoning in *United States v. Turkette*, 452 U.S. 576 (1981). The theory apparently derives from an anti-infiltration interpretation of RICO, which in turn derives from §1962(a)'s anti-infiltration thrust (Acct. at 15). By superimposing §1962(a) onto §1962(c), petitioners assert that the operation of a RICO enterprise through racketeering cannot constitute §1962(c) conduct unless ill-gotten gains are reinvested: *i.e.*, used to obtain an economic advantage by investment in or infiltration of a business (Acct. at 14-17).

But in *Turkette* this Court affirmed as §1962(c) conduct the operation of a drug and arson enterprise, although there had been no reinvestment or infiltration of any type shown. The Court rejected the notion that RICO is limited to combating infiltrative activity, and recognized that the statute, by prohibiting the "source" activity by which ill-gotten gains are initially obtained, serves both "preventive as well as remedial functions." 452 U.S. at 593.

In short, the economic advantage argument has neither a statutory nor analytical leg to stand on. Like the standing and similar artificial limitations that the petitioners and other RICO defendants have pressed upon courts since the statute was enacted, economic advantage is just another stalking horse for an exception to RICO that would insulate business criminals from liability for their misconduct. But all five circuits that have considered appeals of civil RICO claims arising from ordinary business contexts have declined to create any artificial limitations on §1962(c) or §1964(c) that would preclude victims of business crimes from pursuing RICO actions.

In the court below the petitioners had stressed a "competitive injury" standing limitation, borrowed from antitrust jurisprudence. But the Seventh Circuit rejected it, noting that Congress had explicitly declined an opportunity to enact RICO by "simply amending the antitrust laws to provide remedies for competitive harm caused by racketeering infiltration" (App. at 28a). The petitioners had also argued below that Congress did not intend RICO to encompass ordinary business crimes. After fully considering RICO's statutory language and legislative history (App. at 20a-27a), as well as petitioners' arguments, the court of appeals concluded that "[i]n sum, defendants' profession of alarm at the expansion of federal jurisdiction

over business fraud amounts to nothing less than a dispute with the very design, and not the mere application of the statute" (App. at 24a).

In *Bennett v. Berg*, *supra* 685 F.2d 1053, purchasers of interests in a retirement community alleged that the community's accountants, mortgage lenders, insurance company, developers, attorneys and corporate directors had all caused compensable RICO injuries by operating the community through conduct that included mail fraud. The defendants offered a smorgasbord of reasons for holding RICO inapplicable, including an organized crime limitation, a racketeering injury limitation, and competitive injury. Holding for the plaintiff, the Eighth Circuit rejected them all.

Likewise, in its recent opinion, *Moss v. Morgan Stanley*, *supra* No. 83-7120, the Second Circuit rejected the suggestion that RICO should not apply to "ordinary business or parties" (Slip Op. at 6342) and held:

> "[Courts should not] create standing requirements that would preclude liability in many situations in which legislative intent would compel it. Complaints that RICO may effectively federalize common law fraud and erode recent restrictions on claims for securities fraud are better addressed to Congress than to courts." Slip Op. at 6342; citation omitted (corrected opinion).

The Sixth and Eleventh Circuit have also upheld the applicability of civil RICO in business contexts. The former, in *USACO Coal Co. v. Carbomin Energy, Inc.*, 689 F.2d 94 (6th Cir. 1982), affirmed the issuance of an injunction sought in a shareholders' civil RICO action founded on the conduct of a corporate promoter. The Eleventh Circuit in *Morosani v. First National Bank of Atlanta*, 703 F.2d 1220 (11th Cir. 1983), overruled limita-

tions on RICO adopted by the district court in *Kleiner v. First National Bank of Atlanta*, 526 F.Supp. 1019 (N.D. Ga. 1981), and reinstated the RICO complaint of a borrower against a bank.

The circuits' unanimous conclusion that business crimes should not be excepted from RICO reflects the fact that the statute is unambiguous. Absent "clearly established legislative intent to the contrary" the plain language of RICO must be deemed conclusive. *United States v. Turkette, supra* 452 U.S. at 580. And here, there is no legislative intent to the contrary. The history of the statute shows Congress' intention that RICO be enforced as enacted. That history is reviewed fully in the court of appeals decision and will not be set out again here (App. at 27a-30a). Suffice it to say that upon reviewing it the court held that the erection of barriers or limitations on RICO would not comport with "the central goal" of the statute (App. at 30a). *See also Bennett v. Berg, supra* 685 F.2d at 1058-9.

Finally, the petitioners assert that a "clear statement" of Congress' intentions is needed since RICO brings the federal government into areas that formerly were the sole province of the states (Acct. at 13-14). But both this Court and the court of appeals have found just such a clear statement: "[T]he language of the statute and its legislative history indicate that Congress was well aware that it was entering a new domain of federal involvement through the enactment of this measure." *United States v. Turkette, supra* 452 U.S. at 586. *See also* App. at 36a.

Contrary to petitioners' assertions, there is no disarray among courts concerning the scope of civil RICO (Acct. at 9), for the decision below and those of the Second, Sixth, Eighth and Eleventh Circuits are sufficient to resolve any confusion that may earlier have existed at

the district court level. The circuits are unanimous: RICO should be enforced as enacted, unencumbered by any artificial limitations—including "economic advantage"—that effectively create a business-crime exception to its prohibitions.

III.

RESERVE, VICTIMIZED BY THE PETITIONERS, IS NOT AND SHOULD NOT BE ESTOPPED FROM PURSUING ITS REMEDIES.

The accountant and reinsurance petitioners' second question presented for review, may a RICO action be asserted by a corporation which "initiated the alleged fraud . . . ," like their first, is based upon deliberate misrepresentations about the complaint and the opinion below. The complaint does not allege that Reserve "participated in a RICO violation" (Acct. at 21), nor did the Seventh Circuit "recognize" that under Illinois law the individual defendants' fraud would have been attributable to Reserve (Acct. at 21).

The accountant and reinsurance petitioners, isolating the fact that some of the individual defendants were officers and directors of Reserve, argue that because those defendants participated in the fraud their misconduct should be imputed to Reserve. But the court of appeals recognized that there is no universal legal principle compelling the imputation of an officer's or director's misconduct to his company without regard to the facts of a particular case. Instead, the court held that under both statutory and common law, a threshold determination of whether the alleged misconduct benefited the company must precede a consideration of attribution principles. Here the court of appeals found that far from benefiting Reserve, the petitioners victimized the company:

> "[Reserve was] fraudulently continued in its business past its point of insolvency and systematically looted of its most profitable and least risky business and more than $3,000,000 in income." App. at 8a.

It observed further that: "[T]he prolonged artificial insolvency of Reserve benefited only Reserve's managers and the other alleged conspirators, not the corporation" (App. at 9a). These facts, the Seventh Circuit held, did not "even trigger" the analysis of the other factors pertinent to whether the officers' and directors' misconduct should be imputed to Reserve (App. at 9a). In light of the allegations of the complaint and the Seventh Circuit's construction of them, Reserve may not be estopped from bringing its RICO claim.

Nor *should* Reserve be otherwise prevented from pursuing its claim. Petitioners assert that the recovery Reserve seeks is duplicative of that being sought by other parties in different lawsuits. First, this argument overlooks the fact that the Director is the only party suing for Reserve's own, distinct injuries, which include the loss of income from Reserve's profitable business and the loss of assets dissipated by the petitioners. Second, petitioners' argument founders because, as the Seventh Circuit reasoned, to the extent this complaint may overlap other lawsuits:

> "[T]he other actions . . . based on these alleged events have yet to result in any recovery. Of course, if the Director recovers successfully in the instant suit, the defendants in these actions will be able to assert the previous satisfaction of the claims of the shareholders, policyholders, and creditors of Reserve as a bar to subsequent recovery." App. at 2b.

In fact, this lawsuit provides the vehicle that will best protect against duplicative recovery because the Director is proceeding, pursuant to the Illinois statutory liquidation scheme, for the benefit of Reserve and of its

policyholders and creditors (App. at 10a). *See* Ill.Rev.Stat. ch. 73, para. 817. Any potential for double recovery can be resolved in the context of this single action. *Compare, Associated General Contractors of California, Inc. v. California State Council of Carpenters*, 103 S.Ct. 897 (1983).

In sum, an Illinois insurance company having been victimized, the Director, acting pursuant to the Illinois statutory scheme, should be able to pursue the full range of Reserve's remedies, including this RICO action.

IV.

THERE IS NO CONFLICT BETWEEN THE SEVENTH AND EIGHTH CIRCUITS: AUDITORS AND OTHER SO-CALLED "OUTSIDERS" CAN BE DEFENDANTS IN §1962(c) ACTIONS.

The accountant and reinsurance petitioners ask that this Court review whether the complaint sufficiently alleges that they "conducted or participated in the conduct of ARC's affairs" (Acct. at 1, 23-25). Their claim is that in order to violate §1962(c) a defendant must be involved in the "management or operation" of an enterprise, and that as a matter of law neither an accountant nor a reinsurer can be so involved. Contrary to petitioners' assertion that the Seventh Circuit "ignored" this argument (Acct. at 24), the court responded directly to it:

> "As this court has noted before, in finding that a non-manager defendant arsonist met the §1962(c) requirement, 'The nature of racketeering connections to an otherwise legitimate business suggests that elements outside a company may assist in obtaining the company's illegal goals.' Thus, '[t]he substantive proscriptions of the RICO statute apply to insiders and outsiders—those merely "associated with" an enterprise—who participate directly and indirectly in

> the enterprise's affairs through a pattern of racketeering activity. Thus, the RICO net is woven tightly to trap even the smallest fish, those peripherally involved with the enterprise.' Other courts as well have had little trouble in finding that defendants who are not managers or employees in the colloquial sense are nevertheless reached by §1962(c). . . . [citing cases]" App. at 34a-35a; internal citations omitted.

Further, this aspect of the Seventh Circuit's decision is not inconsistent with the Eighth Circuit's discussion of the defendants' participation in its *en banc* opinion in *Bennett v. Berg, supra* 710 F.2d at 1361. There, the court did not hold that accountants and other outsiders *could not* be participants in a RICO enterprise; it merely expressed concern regarding the paucity of the factual basis underlying the conclusory allegation of each defendant's participation in misconduct. 710 F.2d at 1364. Here, by contrast, as the Seventh Circuit commented, the Director's complaint sets forth a factual basis regarding each petitioner's participation in the misconduct alleged (App. at 36a). Accordingly, the petitioners ask that certiorari be granted simply to have one last opportunity to convince a court that the pleadings say less than the Seventh Circuit and district court held they do.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted,

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No. 83-539

IN THE

Supreme Court of the United States

October Term, 1983

ARTHUR ANDERSEN & CO.,
COOPERS & LYBRAND,
ALEXANDER GRANT & COMPANY,
SOCIETE COMMERCIALE DE REASSURANCE and
SCOR REINSURANCE COMPANY,
Petitioners,

v.

JAMES W. SCHACHT, the Acting Director
of Insurance of the State of Illinois and
Liquidator of Reserve Insurance Company,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
I. RESPONDENT IS INCORRECT IN CONTENDING THAT THE COURT OF APPEALS DID NOT DECIDE THE QUESTIONS PRESENTED	1
II. RESPONDENT IS INCORRECT IN CONTENDING THAT THE DECISION OF THE COURT OF APPEALS IS SUPPORTED BY DECISIONS IN OTHER CIRCUITS	3
III. THE TIME IS RIPE FOR THIS COURT TO REVIEW A RICO TREBLE DAMAGE CASE	5
CONCLUSION	6

Pursuant to Supreme Court Rule 28.1, a list of parents, subsidiaries and affiliates of corporate petitioners was submitted in the petition (Pet. 2) and remains accurate. A petition for review of the same decision has been filed, *Brown et. al v. Schacht*, No. 83-548.

TABLE OF AUTHORITIES

Page

CASES:

Bennett v. Berg, 685 F.2d 1053 (1982), *modified en banc*, 710 F.2d 1361 (8th Cir. 1983), *petition for cert. filed*, 52 U.S.L.W. 3310 (U.S. October 8, 1983) (No. 83-587) 4

Cenco, Inc. v. Seidman & Seidman, 686 F.2d 449 (7th Cir.), *cert. denied*, 103 S. Ct. 177 (1982) 4

Dakis v. Chapman, [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,498 (N.D. Cal. 1983) 3

Decker v. Massey-Ferguson, Ltd., 681 F.2d 111 (2d Cir. 1982) 1

Guerrero v. Katzen, No. 82-2426 (D.D.C. July 29, 1983) 3

Morosani v. First National Bank of Atlanta, 703 F.2d 1220 (11th Cir. 1983) 4

Moss v. Morgan Stanley, [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,478 (2d Cir. 1983) 3

Oil Resources, Inc. v. Quantum Resources Corp., No. C-82-1230W (D. Utah September 30, 1983) 3

Russello v. United States, 52 U.S.L.W. 4003 (U.S. November 1, 1983) (No. 82-472) 5

Trane Company v. O'Connor Securities, [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,502 (2d Cir. 1983) 3

United States v. Turkette, 452 U.S. 576 (1981) 5

USACO Coal Co. v. Carbomin Energy, Inc., 689 F.2d 94 (6th Cir. 1982) 3

STATUTES:

18 U.S.C. § 1964(c) 2

In an effort to shield the opinion of the court of appeals from review, respondent asserts as proven fact matters that at best are merely allegations,[1] distorts the holding of the court below, and misstates the points contained in the petition for certiorari. Such tactics cannot obscure the importance of this case and the questions it presents.

I. RESPONDENT IS INCORRECT IN CONTENDING THAT THE COURT OF APPEALS DID NOT DECIDE THE QUESTIONS PRESENTED.

The court of appeals held that a RICO treble damage action may be brought by " 'any person' who possesses the rudimentary connection with the operation of an enterprise through predicate offenses or who suffers injury therefrom. . . ." (Pet. App. 36a). The court of appeals itself characterized the RICO treble damage provision, as so construed, as a "runaway treble damage bonanza for the already excessively litigious" and called it a "dramatically expansive, and perhaps insufficiently discriminate, tool for combating organized crime." (*Id.*).

In so holding, the court of appeals addressed the three questions presented to this Court for review in the petition. Respondent's contention to the contrary (Br. In Opp. i, 11) is refuted by the court of appeals' opinion, which

— rejected injury limitations on RICO treble damage actions that would prevent them from "federaliz[ing]

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[1] Contrary to implications in respondent's brief in opposition (pp. 3-5), nothing in the court of appeals' opinion indicates that that court or any other has found any substantiation for respondent's allegations. The court of appeals specifically declined to express any judgment on the facts or merits of the complaint (Pet. App. 10a, 37a). Although the district judge found the allegations sufficient under F.R.Civ.P. 9(b), the district judge's three-sentence disposition of the issue (Pet. App. 4c) is erroneous and inconsistent with more recent authority, *see, e.g., Decker v. Massey-Ferguson, Ltd.*, 681 F.2d 111 (2d Cir. 1982). The Rule 9(b) issue was not certified by the district court for interlocutory appeal to the Seventh Circuit nor was the district court's treatment of the Rule 9(b) issue briefed by petitioners in the Seventh Circuit or decided by that court. We shall not otherwise respond to this aspect of the brief in opposition, except to assure the Court that we will rebut the allegations, if necessary, in an appropriate forum.

the common law of 'garden variety' business fraud and eclips[ing] the federal securities laws" (Pet. App. 20a-32a) and sustained the complaint on the theory that the cause of injury was the alleged "*defrauding*" of the state insurance department (Pet. App. 31a, emphasis added);[2]

— concluded that a fraud-based RICO treble damage claim could be brought by a wholly owned subsidiary corporation that was plainly not defrauded by actions of the subsidiary's parent and sole shareholder and that was suing for the same damages claimed by other litigants (Pet. App. 5a-14a); and

— ruled that the RICO damage action could be maintained against outside accountants and reinsurers, even though the complaint pleaded no facts showing that these outside entities conducted the affairs of the enterprise. (Pet. App. 33a-35a).

The importance of the issues thus decided was recognized not only by the Seventh Circuit panel, but also by those Seventh Circuit judges who voted to rehear the case *en banc*.

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[2] Contrary to statements by respondent, petitioners are not arguing before this Court and did not argue in the court of appeals that a *violation* of 18 U.S.C. § *1962(c)* requires proof of "an economic advantage for the perpetrator." (Br. In Opp. 11). Instead, under point I of the petition, petitioners have addressed the type of *injury* for which a plaintiff may obtain a treble damage *remedy* under 18 U.S.C. § *1964(c)*. Legislative history cited in the petition (pp. 15-18)—which respondent is unable to refute—indicates that Congress intended 18 U.S.C. § 1964(c) to redress a specific form of economic disadvantage distinctively caused by a RICO violation. This issue concerns the requirements for seeking damages under 18 U.S.C. § 1964(c), not the requirements for establishing a violation of § 1962(c). The court of appeals addressed this issue (Pet. App. 27a-30a) and it is ripe for review.

II. RESPONDENT IS INCORRECT IN CONTENDING THAT THE DECISION OF THE COURT OF APPEALS IS SUPPORTED BY DECISIONS IN OTHER CIRCUITS.

While not disputing that a large number of district court decisions are contrary to the decision below,[3] respondent contends that there is support for the court of appeals' decision in four other circuits besides the Seventh (Br. In Opp. 13). The cases respondent cites, however, refute that contention.

In *Moss v. Morgan Stanley,* [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,478 at n.16 (2d Cir. 1983), the Second Circuit, in a corrected opinion, expressly stated that a "growing number of courts . . . have limited standing under 18 U.S.C. § 1964(c)" and reserved decision on the type of injury limitations on RICO treble damage actions discussed by petitioners. (Pet. 18-20).[4] A few days after *Moss,* a different Second Circuit panel indicated that there may be another limitation on RICO treble damage actions in that circuit, reserving decision on whether a private RICO action may be brought against a defendant not convicted of committing predicate acts. *Trane Company v. O'Connor Securities,* [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,502 (2d Cir. 1983).

The Sixth Circuit in *USACO Coal Co. v. Carbomin Energy, Inc.,* 689 F.2d 94 (6th Cir. 1982) did not discuss injury requirements for a RICO treble damage action at all, except to observe that the statute requires injury to "business or property by reason of a violation of § 1962," 689 F.2d at 95, as opposed to § 1961—an observation that supports petitioners. The Sixth Circuit found arguments concerning RICO in that case to be "superfluous" because the court was reviewing the grant of a

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[3] *See, e.g.,* in addition to cases cited at Pet. 18-20, *Dakis v. Chapman,* [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,498 (N.D. Cal. 1983); *Oil Resources, Inc. v. Quantum Resources Corp.,* No. C-82-1230W (D. Utah September 30, 1983); *Guerrero v. Katzen,* No. 82-2426 (D.D.C. July 29, 1983).

[4] The corrected opinion in *Moss,* issued a few days after the release of the typescript opinion, restored a portion of footnote 16 of the opinion that had been dropped in the initial printing. The full text of footnote 16 of *Moss* is reprinted at 15 BNA Sec. Reg. & L. Rep. 1877 (October 7, 1983).

preliminary injunction *not* issued because of a RICO claim, but issued only in connection with a breach of fiduciary duty claim. 689 F.2d at 96. Similarly, in *Morosani v. First National Bank of Atlanta,* 703 F.2d 1220 (11th Cir. 1983), the Eleventh Circuit reversed the dismissal of a private RICO suit on the ground that the district court had erroneously defined the predicate act of mail fraud; the court of appeals declined to reach any other question and remanded the case.

Finally, the Eighth Circuit in *Bennett v. Berg,* 685 F.2d 1053 (1982), *modified en banc,* 710 F.2d 1361 (8th Cir. 1983), *petition for cert. filed,* No. 83-587 (October 8, 1983) [5] rejected some of the injury limitations for RICO treble damage actions discussed by petitioners, but did not address others. Furthermore, the Eighth Circuit *en banc* required the district court to give special consideration to the issue of the participation of each defendant in the conduct of the affairs of the enterprise (*see* Pet. point III), in stark contrast to the decision below. While respondent contends that the decision below dealt with the participation requirement of 18 U.S.C. § 1962(c), the very text of the opinion below respondent cites addressed only the issue of whether the reinsurers were "employed by or associated with" an enterprise. (Pet. App. 33a-34a). The requirement of conducting the affairs of the enterprise is distinct from the requirement of association under § 1962(c), but the court below addressed only the latter and did not apply the former.

In short, the court of appeals in this case has gone where other courts have been unwilling to go. Indeed, the Seventh Circuit panel in this case has given short shrift to a prior Seventh Circuit decision, authored by one of the judges who dissented from the refusal to rehear this case *en banc,* which observed that Congress did not intend to create "waves of treble damages suits" in the "wake of every RICO violation." *Cenco, Inc. v. Seidman & Seidman,* 686 F.2d 449, 457 (7th Cir.), *cert. denied,* 103 S. Ct. 177 (1982).

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[5] The petition in No. 83-587, *Prudential Insurance Company of America v. Bennett,* filed approximately one week after the instant petition, seeks review of various aspects of the Eighth Circuit's *Bennett* decision.

III. THE TIME IS RIPE FOR THIS COURT TO REVIEW A RICO TREBLE DAMAGE CASE.

This is not just another RICO case; it is *the* case in which RICO treble damage actions are being offered to persons whose injuries were not contemplated by Congress when it enacted the organized crime legislation of which RICO is but one title. In acknowledging that its interpretation of 18 U.S.C. § 1964(c) allowed the provision to become a "runaway treble damage bonanza for the already excessively litigious" (Pet. 36a), the court of appeals was acknowledging that, under its interpretation of the statute, RICO will become the vehicle of choice for plaintiffs alleging "fraud" to seek treble damages, attorneys' fees and federal jurisdiction.

The Seventh Circuit panel considered this result to be compelled by this Court's decision in *United States v. Turkette*, 452 U.S. 576 (1981), even though *Turkette* was a criminal case and this Court observed there that the civil provisions of RICO were more limited and could not be used to "narrow" the criminal provisions. *Id.* at 585. Similarly, litigants such as respondent and other courts may read certain language in this Court's recent decision in *Russello v. United States*, No. 82-472, (November 1, 1983) to support the result reached by the Seventh Circuit panel, even though the "sole issue" in *Russello* concerned the definition of an "interest" subject to forfeiture at the government's initiative under 18 U.S.C. § 1963(a)(1). Slip op. at 4.

Unless this Court promptly decides the proper scope of the RICO treble damage provision, the decision of the court of appeals in this case will undoubtedly stimulate an enormous increase in RICO treble damage lawsuits in the already overburdened United States district courts. The Court observed that *Russello* was "yet another case" concerning RICO. Slip op. at 1. If the decision of the Seventh Circuit panel is allowed to stand, *Russello*—a government case—will be only the tip of the iceberg; the deluge of private RICO treble damage cases will have only begun.

CONCLUSION

The petition for certiorari should be granted. If certiorari is granted in No. 83-587, *supra* n.5, the instant petition should be granted and the cases set for argument in tandem.

Respectfully submitted,

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Dated: November 7, 1983

No. 83-539

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

ARTHUR ANDERSEN & CO., COOPERS & LYBRAND, ALEXANDER GRANT & COMPANY, SOCIETE COMMERCIALE DE REASSURANCE and SCOR REINSURANCE COMPANY,

Petitioners,

—v.—

JAMES W. SCHACHT, the Acting Director of Insurance of the State of Illinois and Liquidator of Reserve Insurance Company,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MOTION OF PEAT, MARWICK, MITCHELL & CO. FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE* IN SUPPORT OF THE PETITION AND BRIEF *AMICUS CURIAE* IN SUPPORT OF THE PETITION

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November 1, 1983

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

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The petitioners have consented to the filing of the brief *amicus curiae*. The respondent has declined to consent. This motion is timely since the petition was filed and served by mail on September 29, 1983.

The movant, like three of the petitioners is a firm engaged in the practice of the profession of accounting. It believes that the decision below radically misconstrued the provisions and intent

of the Racketeer Influenced and Corrupt Organization Act ("RICO") by applying it to the accounting firm petitioners and their reports. The *amicus*, itself a defendant in RICO-based private damage actions, has a direct and vital interest that the scope of the treble-damage remedy of the RICO statute be determined by the Court and believes that the brief *amicus curiae* will aid the Court in its review of the petition.

The movant respectfully requests that it be granted leave to file the accompanying brief *amicus curiae* in support of the petition for a writ of certiorari.

Respectfully submitted,

s/ VICTOR M. EARLE, III

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TABLE OF CONTENTS

	PAGE
Table of Authorities	ii
Interest of the *Amicus Curiae*	1
Reasons for Granting the Writ	3
Conclusion	5

TABLE OF AUTHORITIES

Cases PAGE

Blue Chip Stamps v. *Manor Drug Stores*, 421 U.S. 723 (1975) 3

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. *Curran*, 456 U.S. 353 (1982) 4

Schacht v. *Brown*, 711 F.2d 1343 (1983)..... 3

United States v. *Turkette*, 452 U.S. 576 (1981) 2

Statutes

Commodity Futures Trading Act of 1982, 96 Stat. 2322, *codified at* 7 U.S.C. § 25 (Supp. 1983)..... 4

Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§ 1961 *et seq.* (Supp. 1983) . .*passim*

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BRIEF *AMICUS CURIAE* OF PEAT, MARWICK, MITCHELL & CO. IN SUPPORT OF THE PETITION

INTEREST OF THE *AMICUS CURIAE*

This brief in support of the petition for a writ of certiorari is submitted on behalf of Peat, Marwick, Mitchell & Co. as *amicus curiae*.

The *amicus curiae*, like three of the petitioners, is a firm engaged in the practice of the profession of accounting. It reports as an independent public accountant upon its examinations of the financial statements of governmental bodies and public and private enterprises.

It is not "employed by or associated with" its clients, but rather is engaged as a professional firm and its association is with the financial statements upon which it reports. It does not "acquire or maintain interests" in its clients—its profession's requirement of independence forbids any such relationship. It does not "conduct or participate in the conduct of the affairs" of its clients, rather it examines and reports upon the financial statements which reflect its clients' affairs.

An accounting firm simply does not engage in the activities prohibited by 18 U.S.C. § 1962 even if a reckless plaintiff is prepared to allege that the firm's report concerning a client's financial statements is an instance of "racketeering activity" under 18 U.S.C. § 1961(a). The issuance of the accountant's report is not itself "a violation of section 1962", which is the gravamen of the treble-damage action of 18 U.S.C. 1964(c). The report does not cause injury of the sort—takeover or destruction of an enterprise with the fruits of racketeering activity—which is the subject of the treble-damage remedy. "Congress has provided civil remedies for use when circumstances so warrant." *United States* v. *Turkette*, 452 U.S. 576, 585 (1981).

The *amicus curiae* believes that the decision below radically misconstrued the provisions and intent of the Racketeer Influenced and Corrupt Organization Act ("RICO") by applying its treble-damage remedy to the accounting firm petitioners and their reports. The *amicus curiae*, itself a defendant in RICO-based private damage actions, has a direct and vital interest that the scope of the treble-damage remedy of the RICO statute be determined by the Court.

REASONS FOR GRANTING THE WRIT

1. The conflicting decisions of courts of appeal and district courts cited by the court below and in the petition demonstrate the doubts which surround the construction of the RICO treble-damage remedy.

Accepting that the statute is not status-based and that affiliation with "organized crime" is not a prerequisite to its applicability does not mean, as the court below would have it, that there is "no legitimate principled criterion" (*Schacht* v. *Brown*, 711 F.2d 1343, 1356 (1983)) for delimiting the remedy. As shown above in connection with the interest of the *amicus curiae*, the issuance of an accountant's report neither violates § 1962, which is the gravamen of the § 1964(c) action, nor causes injury of the sort which the § 1964(c) remedy is intended to redress.

The scope of the RICO remedy is fairly in doubt. Its drastic nature is certain. It demands authoritative construction by the Court.

2. The effect of the decision below is to federalize the co mon law tort of deceit (as well as to render nugatory the remedies of the federal securities laws). The argument of the court below that such federalization has already been accomplished in the criminal field by the mail fraud statute itself (*Schacht*, *supra*, 711 F.2d at 1355) does not answer the question of whether Congress intended the RICO remedy to transfer common law fraud actions from the state courts to the civil dockets of the federal courts.

This effect upon the federal courts is compounded by the characterization and drastic nature of the remedy. No professional firm or legitimate business concern will accept without contest the allegation that its conduct is racketeering activity and that it is a racketeer influenced and corrupt organization. The "danger of vexatious litigation", *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740 (1975), is, so it may be

said, trebled by the RICO remedy. Unless and until the Court speaks, no defendant will fail to challenge by motion a RICO-based claim.

This impact upon the business of the federal courts particularly calls for the Court's consideration of the RICO remedy's scope.

3. That the question arises upon an appeal under 28 U.S.C. § 1292(b) from the denial of a motion to dismiss does not argue against the Court's review.

In addition to the precedents cited by petitioners (Pet., p. 10) is *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353 (1982). There, motions to dismiss (granted and denied in separate actions) had raised the question of the existence *vel non* of implied private damage remedies for violations of the Commodity Exchange Act.

In finding implicit congressional approval of such a remedy which had been fashioned by the courts, the Court left open questions as to the elements of liability, causation and damages (456 U.S. at 395). The Court's decision was followed by the enactment by Congress of express damage remedies in § 235 of the Commodity Futures Trading Act of 1982, 96 Stat. 2322, *codified at* 7 U.S.C. § 25 (Supp. 1983), which answered these open questions.

Here, too, the Court's construction of the RICO treble-damage remedy would provide the occasion for Congress to consider whether its intent had been accurately expressed in the statutory provisions it enacted.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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